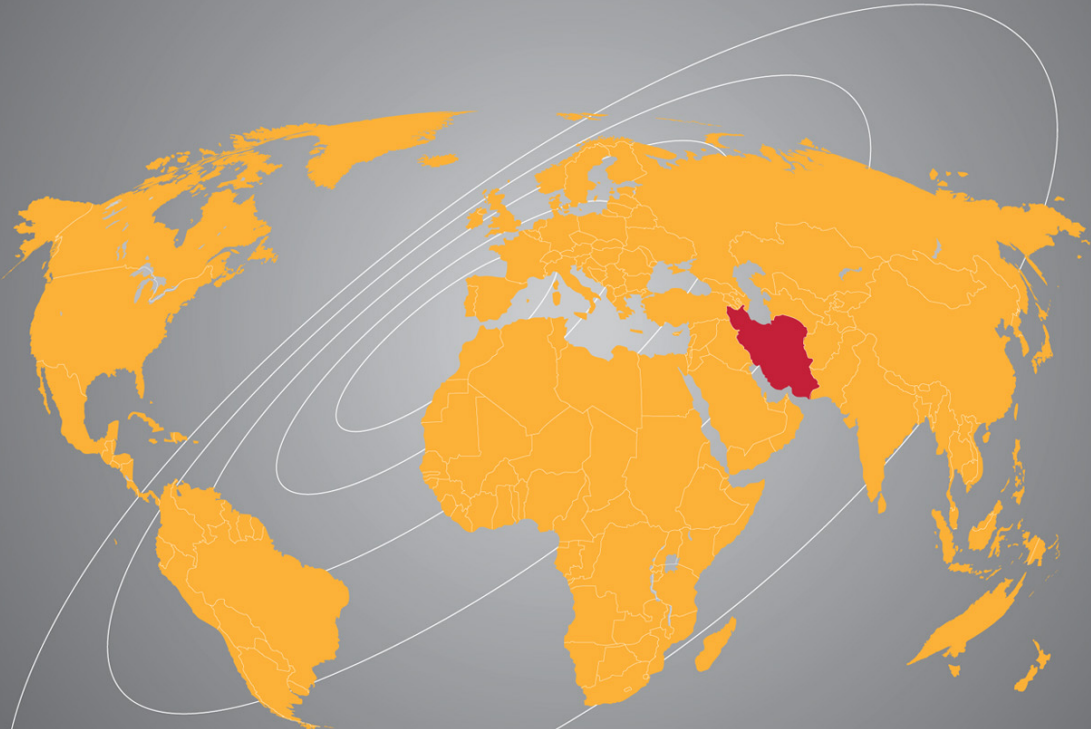




# Reintegrating Iran with the West

## Challenges and Opportunities



**Mohammad Elahee,  
Farid Sadrieh and  
Mike Wilman**

31

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# **REINTEGRATING IRAN WITH THE WEST: CHALLENGES AND OPPORTUNITIES**

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# REINTEGRATING IRAN WITH THE WEST: CHALLENGES AND OPPORTUNITIES

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## Preface

Thirty six years after the Islamic Revolution, Iran stands at the threshold of a new chapter in its tumultuous relations with the Western world. Albeit it may be difficult to predict the parameters that will guide this interface, there can be no doubt about the new ascendance of pragmatism among all parties. On the one hand, in Iran, the ruling elite confronts a weakening ideological grip and a crisis of legitimacy, while at the same time, finds itself unable to avoid mounting social and economic challenges which have long been neglected, thanks to oil exports revenues. On the other hand, major world powers have recognized that Iran, with its rich history, culture, and political and economic influence can no longer be reduced to the status of a pariah state, to be contained and marginalized. While today's Iran cannot be ignored, its present importance pales compared to what its future might hold, as a rising economic and political power. This promising future would reconnect Iran with its glorious past and allow it to recover its place in the concert of nations after a decades-old hiatus.

Indeed, Iran, located at the cross-roads of civilizations and inter-continental trade, has, throughout its long history, played an important role in the movement of goods, people, and ideas. The political factors that have hobbled Iran's development in recent years should not prevent the scholar, the business practitioner, or the policymaker to appreciate Iran's potential as a key player in the economic, political, and technological development of its region and beyond.

This book has been written in recognition of the aforementioned potential. It purports to provide its readers with a fuller understanding of the economic complexities of the present and the promise of a future rebirth in an important country, perhaps the last emerging market; a country whose potential has been dormant or held in check, but whose significance has remained unaffected.

The recent thaw in the relations between Iran and the West, following the election of Hassan Rouhani has lent additional urgency to the writing of this book, as the prospect of loosening of economic sanctions and détente between adversaries, clearly expands the realm of possibilities.

The people of the West and the greater Middle East could, in a not too distant future, build a bridge of cooperation with Iran, based on shared interests, an outcome that would be beneficial to the entire world. Opportunities exist for the development of geostrategic, cultural, technological, political, trade, and economic relations. However, the primary focus of this book is trade and investment, with ancillary areas addressed only to the extent that they affect the former two. Indeed,



while nuclear negotiations have generated a wealth of analyses focusing on the political and strategic significance of the rapprochement between the West and Iran, the possible economic ramifications have yet to be fully investigated.

In sum, although Iran is a large, untapped market and a great potential contributor to the world economy, after more than three decades of relative isolation, the state of our knowledge about this country has been constrained by the dearth of exchanges and the opacity of Iranian society. Based on this realization, as editors of this book, we have strived to bring together the perspectives of scholars from a variety of backgrounds. Together, these contributors offer a broad overview of the challenges and opportunities presented by the gradual, and likely fitful, reintegration of Iran into the world economy.

This book does not aim to be exhaustive or to cover the whole gamut of mutually beneficial relationships that could arise from a lessening of political and ideological impediments to closer ties. It strives, instead, to explore the potential offered by cooperation in areas of more immediate interest to businesspeople, international organizations, civil societies, social thinkers, and policymakers.

The timeliness or importance of this book is not predicated on the success of the current negotiations between Iran and the West. These may or may not come to fruition, although the recent drop in oil prices and America's new engagement with another longtime foe, Cuba, point to the likelihood of compromise. However, the reintegration of Iran in the global economy is not contingent on any single fact or process, as critical as they may be. Indeed, the question of the emergence of Iran as a key economic player should not be posed as whether it will happen or not, but rather when will it happen. A closer look at the Iranian society suggests that the internal dynamics of Iranian society have reached a critical juncture: a young and well-educated population yearning for opportunities is confronted to a shackled economy, battered by sanctions and corruption that cannot even begin to address its needs. Externally, the strategic necessity to secure oil from the region has begun to recede as the paramount reason for the West's engagement with the Middle East. It is increasingly being replaced by a search for stability, prosperity, and new markets. The stage is set for the reemergence of Iran after years of isolation.

The book is organized into three parts preceded by an introductory chapter and followed by a brief conclusion.

The introductory chapter will revisit Iran's contributions to world civilization through cultural diffusion and trade. Throughout its long history, Iran has been a central node in the trade routes along which traveled people, ideas, and goods.

In recognition of the enduring importance of energy exports to Iran's economy, the next chapter, the first of three focusing on Iran's major industries, is entirely devoted to the petroleum sector. Deprived of investment and technology, Iran's oil infrastructure is in dire need of Western capital and expertise to ramp up sagging output and manage facilities efficiently. Iran's immense oil reserves are surpassed only by its vast natural gas resources, which together present great opportunities for

expansion. Iran's exports earnings have been and are likely to remain heavily reliant on the energy sector. Chapter 3 turns to Iran's non-oil exports and its fitful development. Although insignificant in terms of income when compared to the oil sector, these exports are an important source of employment and critical to lay the base for diversifying the economy. This sector has been devastated by the loss of access to major markets, the difficulties in securing needed production inputs and the challenges of international payments in the face of crippling economic sanctions. Yet, should the political impediments to economic activities be eliminated, the potential of the sector is far from negligible. Chapter 4 examines a major industry in the non-oil sector, automotive production, and assembly. Prior to 2012, when new E.U. sanctions came into force, many European companies were manufacturing and selling vehicles in Iran. As a middle-income country, Iran and its 78 million inhabitants represent indeed a lucrative market. Most vehicles are absorbed by the domestic market, with some exports to neighboring countries. The lifting of sanctions will unleash the full potential of this sector and companies like Peugeot and Renault are poised to resume their activities as soon as the political impediments are eased. It must be recognized, however, that even in the absence of sanctions, the challenges of operating in the Iranian market are daunting, particularly in light of the fact that any meaningful privatization of the economy has yet to take place. Nevertheless, the rewards can also be very attractive and opportunities exist in a number of sectors. Chapter 5 focuses on the Iran's political economy and the potential role of the diaspora. The Islamic Revolution of 1979 has spawned an Iranian exile community across the world whose numbers surpass the million mark. Often, well-educated members of the middle class, many members of this diaspora are today well-adjusted and prosperous citizens of their host country. Many successful businessmen and entrepreneurs, leading figures in major companies, scholars, scientists, and other knowledge workers hail from that community. These Westerners of Iranian descent can play a major role as facilitators or direct contributors to investments in their ancestral land. They could also be pivotal in influencing or even shaping the policies of their host country toward Iran.

The next two chapters focus on the nuclear negotiations between Iran and the five-member countries of the UN Security Council and Germany. Chapter 6 examines the rationale for negotiations for the parties, the dynamics of coercive bargaining, and the use of threats and incentives as applied to the contentious relationship between Iran and the United States in particular. The chapter demonstrates how the strategic use of economic coercion and inducements can increase the likelihood of an agreement. Chapter 7 takes a geopolitical approach in analyzing the likely effects of an agreement, arguing that the nature and scope of the latter will determine to a large extent its consequences. The interests and motivations of different constituencies within Iran and the United States in embracing or obfuscating improved relations are scrutinized. Finally, the calculus and influence of regional and global players such as Israel, the European Union, Russia, and China are examined and their often-conflicting interests discussed.

Chapter 8 focuses on Iran's trade relations with India. Although the two countries' bilateral relations are far from having reached their full potential, they have grown tremendously over the last decade. However, in the last few years, the tightening sanctions on Iran have affected negatively the volume of transactions as payments as well as shipping and insurance have become more difficult to secure. It remains that the two countries have complementary needs as a growing India experiences an increasing need for energy imports while supplying Iran with some of its food and industrial needs. Chapter 9 investigates Iran's relationship with China. Perhaps even more than India, China is of critical importance for Iran in more than one way. Not only is China the biggest buyer of Iran's oil exports, but the two countries have numerous areas of shared interests from a strategic and geostrategic perspective. What China perceives as attempts at containment and encirclement by the West and its Asian allies can only be beaten back by reaching out to countries that share the same concerns about the United States' designs, first and foremost, Iran. Even after a thaw in relations between Iran and the West, China is likely to remain a privileged trade and strategic partner for Iran. Chapter 10 brings this book to a close by focusing on the complex and contentious relationship between Iran and the United States. It might come as a surprise to learn that the two countries do, indeed, share strategic interests in a number of areas, as the title of the chapter suggests. Nevertheless, the tormented history between the two countries and the weight of resentments and mutual recriminations cannot be underestimated. Political machinations by domestic interest groups in both countries and external political considerations add additional layers of complexity to the fraught relationship. The chapter concludes by pointing out that it is in the best interests of the two countries to reach an agreement.

To be sure, pragmatism and the pursuit of national interests create a powerful dynamic toward reaching compromise, but history has shown that this dynamic is neither irresistible nor irreversible. Reconciliation is a long road rather than a destination, and it requires continual vigilance from those committed to tread that path.

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*Farid Sadrieh*

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## **PART I**

# **IRAN IN THE GLOBAL ECONOMY**



## Chapter 1

# A Historic Perspective on the Iranian Contributions to World Civilization and Global Trade

Farid Sadrieh

### Abstract

Iran's influence on a number of cultural, political, and economic areas including religion and philosophy, literature, science and education, as well as statecraft is surveyed. The chapter also discusses how successive Iranian empires contributed to the growth of world trade and commerce. It is shown that Iran has had a great impact on the world throughout its long history and that its prominent role in contributing to the human heritage stands in sharp contrast to its isolation today, which is construed as a historical anomaly.

**Keywords:** Culture; religion; literature; science; administration; trade

### 1.1. Introduction

Iran's cultural influence has made itself felt over the world for thousands of years. It is reflected in the arts, in sciences, in philosophy, and in religion, as well as statecraft and international trade. A brief review of Iran's age-old impact on the world



beyond its borders is presented in this introductory chapter. Although this review is far from exhaustive and, indeed, just scratches the surface of the multi-faceted influence that Iran has exerted over the centuries, it helps in understanding the incongruity of Iran's status as a pariah over the last decades.

## 1.2. Iran: A Cradle for Religious Thought

Religion is probably the earliest vehicle for the propagation of ideas. One of the earliest religions in the world and the first to formulate a monotheistic view and principles embodied in a holy text, Zoroastrianism, originated in Iran. Zoroaster is believed to have lived between 3000 and 5000 years ago. His influence reached far beyond the land of his birth. His vision of a perpetual struggle between evil and good and his call for humankind to embrace and assist the latter, are echoed in major religious philosophies that followed. The concept of a messiah, Saoshyant in the Zoroastrian faith, who will come to lead the final battle against evil, is not, of course, alien to the followers of Abrahamic religions. The Magi who traveled from the East on the night of Jesus's birth are easily identifiable as Zoroastrian priests (called Mogh or Mugh), according to Williams (2010).

Other Iranian religions left also their mark on the West, as well as the East. The dualist vision formulated by Mani (216 AD – 276 AD) has given us more than just the word Manicheism. Although Mani was killed at the instigation of Zoroastrian high priests whose power he challenged, his influence continued to be felt for centuries from as far west as France to as far east as China. In medieval France, the Cathares, followers of a “heretic faith” advocating simplicity and purity, reflecting ideas once preached by Mani, challenged the hierarchy of the Catholic Church and were brutally repressed and finally annihilated. In China, Manicheism or the Religion of Light (Ming-chiao in Chinese) is believed to have survived, in one form or another, until the early twentieth century (Encyclopaedia Iranica, 2015).

In more recent times, the Baha'i faith, whose origins can be traced to nineteenth century Iran, has found adepts among most nations of the world, attracted to its message of peace and universalism. Although severely repressed in its country of origin where followers are subject to various exactions and persecution, it has thrived beyond the borders of Iran and claims five million followers.

Iran's faith-based influence has not been limited to the impact of religions born in that country or within its cultural sphere. Shi'ism, a branch of Islam rooted in the disagreement over the succession of the prophet Mohammad, has become a vehicle for Iran's spiritual as well as political influence in its region. Iranians converted to Shi'ism only during the rule of the Safavid kings in the sixteenth century. Nevertheless, over the past few centuries, Shi'ism has been intertwined with Iranian culture. The Shi'a, who believe that the descendants of the prophet were the only legitimate heirs to political power in the Islamic caliphate, opposed the

ascendency of Abu Bakr and later the Umayyad caliphs. When Hussein, the Prophet's grandson, attempted to seize power in a confrontation that culminated in the battle of Karbala (680 AD), his army, as well as their family members, women, and children, were decimated by the Caliph's troops. The martyrdom of Hussein, reenacted through passion plays and relived by more than a hundred million Shi'a worldwide, symbolizes the worldview embraced by the followers of this branch of Islam, who see themselves as a righteous and just, but oppressed, minority. Iran, where more than half of the world's Shi'a population lives, is home to the holy city of Qum, where students from around the world flock to madrassas in the pursuit of theological learning. Many Shi'a religious leaders, whether based in Qum or in the city of Najaf in neighboring Iraq, provide guidance in all matters affecting the lives of the faithful, including social and political issues. This ensures an effervescence of ideas, continuous debate, and a political engagement that at times leads to challenging and confronting existing powers, mirroring, in the mind of the faithful, Hussein's challenge of the power of those who had usurped the Caliphate.

Thus, Iran's role as a spiritual center of Shi'ism cannot be separated from its commitment to protect the holy sites of Shi'ism beyond its borders, in particular Najaf and Karbala in Iraq, as well as its overt and covert engagement in favor of Shi'a populations throughout the region. The rise to power of a theocratic regime in Iran has resulted in a magnifying of Iran's often controversial activism in the region and an exacerbation of its latent conflict and rivalry with Sunni powers. Iran's backing of Hezbollah in Lebanon, Houthis in Yemen, the Assad regime in Syria, the embattled Shi'a majority in Bahrain, and the beleaguered Shi'a dominated power in Bagdad is well documented. Less known is Iran's projection of soft power through trade with its neighbors, in particular Iraq, and the flows of pilgrims in both directions, as well as the presence of large communities of people of Iranian descent in several Persian Gulf countries. Although Iranian emigration to the West is a relatively recent phenomenon, Iran's cultural reach, through its arts, in particular its literature, stretches back centuries.

### **1.3. Persian Language, Literature and Poetry**

Domestication of animals and plants by previously nomadic people set the stage for the development of agriculture and the creation of permanent settlements. The area called Middle East today was one of the centers of this revolutionary transformation (Diamond, 1997). For the first time in human history, a modicum of food security could be achieved. Early farming communities needed political organization and administration to ensure the security and stability required for agricultural production. The latter, in turn, allowed the freeing of human resources for other purposes than daily survival, be it administration, warfare, or the

creation of arts. The first states developed in Mesopotamia, around agricultural activities. For the first time, a writing system was created to record transactions, laws, and oral traditions, like the epic story of Gilgamesh, a Sumerian-Babylonian poem considered as the first great work of literature. Although on the margins of Mesopotamia, the Iranian tribes traded with the Mesopotamian civilizations, long before establishing their own kingdoms, first in Media, and later throughout the Iranian plateau under the leadership of Cyrus, the founder of the first unified Iranian state. Cyrus conquered neighboring kingdoms, including Babylonia, and founded an empire that was to last over 200 years and bring together a vast territory stretching from Greece to the confines of India. Iran under the Achaemenid rulers became a crucible where art forms from all parts of the empire were integrated and molded. Architecture and sculpture, borrowing from the Babylonian and Assyrian traditions, flourished. Alexander's conquest of Persia led to an infusion of Hellenistic influences, before the revival of Persia under the Sassanid rulers, many of whom were avid patrons of the arts, from music to sculpture to poetry. It is the latter, however, that towers above all other art forms, especially in the post-Islamic period. The triumphant armies of Islam ushered a new chapter in the history of Iran, one that would witness the resurgence of Iran not as a military power, but as a beacon shining through its numerous thinkers, poets, and philosophers and putting its imprimatur on the Islamic world and beyond. Alone among defeated nations crumbling under the wave of Arab conquest, Iran succeeded in maintaining a distinct identity expressed first and foremost by the modern form of the Persian language. The rebirth first takes place in the farthest northeastern reaches of the territory that had comprised historic Iran (present day Tajikistan), the furthest from the seat of Arab power in Baghdad, under the Samanid dynasty, one of the earliest independent Iranian states to be formed after the fall of the empire. Rudaki, a poet in the court of Nasr II, a Samanid king, is considered the father of Persian classical literature (Tabatabai, 2011). Many others followed, contributing to building an impressive body of literature that arguably is the most important contribution of Iran to human civilization. Some of the most prominent are Ferdowsi, the author of the *Shahnameh*, a heroic epic of the exploits of pre-Islamic kings, Khayyam, whose quatrains have been translated in many languages, Nezami, Attar, Rumi, whose mystical poetry is world renowned, Saadi, Ghaznavi, and Hafez.

Persian literature and especially its exquisite poetry had a profound influence in Ottoman Turkey, Mughal India, and Central Asia, thus offering a conduit to expand the cultural reach of Iran far beyond its borders. Persian poetry adorning the walls of Topkapi Palace, the main residence of the Ottoman Sultans for centuries, in Istanbul, as well as the Taj Mahal mausoleum in Agra, India, thousands of miles apart, stand in silent testimony to Iran's cultural reach or soft power over time. For hundreds of years, the learned class in those powerful empires communicated in Persian, and many non-Iranian poets wrote in that language. Persian was the language of administration in India well into the nineteenth century. The

continuing importance of those cultural links is exemplified in modern day Indian leaders resisting Western and especially American pressure to curtail relations with Iran by invoking historical and cultural affinities with that country, whether or not these constitute indeed the main reason for their stated position.

In sum, Iran has had and continues to have a cultural influence on its neighbors that under the right conditions could be leveraged to facilitate closer ties in other areas, such as trade and investment.

## **1.4. Science and Education**

*“Men from the land of Persia will attain scientific knowledge even if it is as far as the Pleiades”*

This quote is attributed to the Prophet Muhammad and appears, along with electrons in orbit around an atom, on 50,000 Rials banknotes in Iran. The successes of Iran’s scientists in its controversial nuclear program, despite countless obstacles, including sabotage, points to a tradition of learning that has deep roots in history. Persia’s first formal university dates back to 271 AD, when the teaching hospital and academic center of Gundishapur was founded (Ebrahimpour, 2008). Scholars from Byzantium, Greece, and India were brought together and instruction was delivered in several languages (Miller, Vandome, & John, 2010). Gundishapur’s golden age lasted several centuries before the Arab conquest. The Persian translation of Greek and Indian texts later became the basis of Islamic knowledge, having been translated into Arabic. The latter, in turn, helped spur the Renaissance in Europe as the knowledge of Greek philosophers and scientists, lost in Europe during the descent of that part of the world into the so-called dark ages, was preserved in the libraries of the Islamic world. The latter, and first and foremost Iranian scientists, added to the body of knowledge inherited from antiquity (Frye, 1989). During the Islamic period, scientists like Razi (Razes) or Farabi (Alfaribus) who lived in the ninth and tenth century were universally known for their contributions in chemistry, medicine, and psychology. Later, Ibn Sina, known in the West as Avicenna (980–1037), arguably changed the face of medicine through his scientific research and discoveries. His books were the basis of medical knowledge and taught in universities around the world for centuries after his death. Omar Khayyam, better known today for his poetry, was a major contributor to the advancement of mathematics and astronomy.

Although the golden age of Islamic scholarship has long ended and starting from the seventeenth century, Iran and the Islamic world entered a period of decline that would last until the beginning of the last century, recent decades have witnessed a revival of interest for learning. The number of university students has surged with females outnumbering males and scientific fields are in high demand. The country’s highly educated youth, chafing under the restrictions imposed through various sanctions that limit their opportunities, have nevertheless excelled in worldwide

competitions and reaped rewards and recognition for their achievements. Maryam Mirzakhani, a Stanford scholar educated in Iranian universities, who was awarded the Fields medal, the most prestigious recognition in Mathematics, in 2014 (Mackenzie, 2014), provides an example of such success.

There is today in Iran a pent-up demand for learning and educational services, as well as research, a demand that would translate in a surge in the number of Iranian students and an increase in collaborative research in various scientific areas, should favorable conditions become available.

### 1.5. Public Administration and Statecraft

In 559 BC, the Persian king Cyrus united the Iranian people after defeating the last Median king and founded an empire that for more than two centuries dominated the ancient world. The Achaemenid Persian Empire was a vast multinational state extending from Greece to India and from Central Asia to North Africa. Its unprecedented power was sustained by an effective and efficient system that was based on a high degree of centralization of the political and military administration while relying on largely decentralized and tolerant policies on other issues (religion, beliefs, customs, etc.). As the world first multiethnic “superpower,” the Persian Empire is credited with many innovations in the area of public administration and governance that ensured its stability and prosperity. Five levels of hierarchical authority formed the political structure of the empire. At the helm, was the king, whose power was uncontested and absolute. The royal court, which included key figures of the state, constituted the second layer, followed by the civilian and military elite, including the central government administrators. The heads of the twenty or more provinces, called satrapies by the Greek chroniclers of the Persian Empire, in particular Herodotus, formed the fourth level of authority. The satraps were responsible for the administration of their realm, collecting taxes, maintaining roads, mobilizing resources, etc. Each satrapy was made of several sub-satrapies whose administrators constituted the final layer of authority. An elaborate system of checks and balances through inspections by direct emissaries of the king ensured loyalty and good governance at the provincial level (Farazmand, 2002). Following the administrative reforms instituted by Darius the Great, weights and measures were standardized, the yearly taxes due to the central government became fixed, and a uniform administrative language was adopted. Under Darius, paved road building also expanded significantly. The Royal Road was a main artery along which relay stations were built so the royal couriers and their horses could be replaced regularly thus assuring the speed of delivery of the messages carried through this ancient postal service. Darius completed the construction of the ancient Suez Canal linking the Nile to the Red Sea. Darius promoted maritime expeditions from the Persian Gulf to India, oversaw the expansion of banking and trade, as commerce flourished thanks to the

political stability, the enforcement of laws, and the use of imperial coins minted during his reign (*Encyclopaedia Iranica*, 2015). The legacy of this first Persian Empire has been incorporated in public administration and governance both at home and abroad. From the Roman Empire to the Islamic caliphate and from the Ottoman Turks to their Safavid foes in Iran, the lessons learned from an efficient bureaucracy have been applied throughout the ages.

A revival of Persian political power occurred under the Sassanid dynasty, which ruled for over three centuries (224 AD – 651 AD) before crumbling under the assaults of the conquering armies of a new religion, Islam. The Sassanid kings recreated, to a large extent, the glory of the earlier Achaemenids, and considered themselves the heirs of their illustrious forebears. Once again, Iranians had created a highly structured system of governance, enabling them to exercise effective control over a large territory although this time they had a major rival, Byzantium. The constant wars between the two empires seriously weakened the Sassanids, although there were periods of peaceful exchange. During one of his military campaigns, Shapur 1st captured the emperor Valerian and 70,000 of his troops (Frye, 1983). The prisoners, brought to Persia, contributed to the ambitious construction projects of the empire and brought with them valuable skills and knowledge. The Sassanids, like the Achaemenids before them, were great builders of cities, palaces, roads, dams, and bridges. They instituted uniform taxation, like their predecessors and developed an efficient bureaucracy. One of the last great kings was Khusrau (531–579), who was a promoter of the aforementioned academy of Gundishapur and known for embracing rational thinking. The Sassanid system of governance was very similar to the Achaemenids: highly centralized and based on a hierarchical structure dominated by the king and his high-level administrators. After the Arab conquest of Iran, and as the new Islamic power expanded its reach, the simple organization inherited from the tribal traditions of Arabia could not address the complex administrative needs of a new entity that continued to absorb diverse populations. The Arab conquerors in fact adopted many Sassanid administrative, financial and agricultural systems, and various cultural practices (Mohammadi-Malayeri & Mohammadi-Malayeri, 2012).

Although the heirs to the Persian throne and the remnants of the defeated imperial army, having taken refuge in Tang dynasty's China, made several unsuccessful attempts to reconquer the lost homeland, it was indirectly that Persians would find their way back to the seat of power. The Abbasid rebellion against the Umayyad Caliphate (750 AD) succeeded in large part thanks to the support of the army of the Iranian Abu Muslim, governor of Khorasan. The new Abbasid caliphate, soon to establish its capital in Baghdad, opened the doors of power to the learned descendants of Persian aristocracy and priestly class. The Barmakid family, whose members became legendary administrators and advisors to the first Abbasid caliphs, rising even to the rank of chief minister (vizier), provide the most prominent example of the Persian influence (van Bladel, 2011). The Barmakids reorganized the state administration and created a centralized bureaucracy to serve the needs of the new power. Yahya Barmaki was a tutor to Harun al Rashid before becoming his chief

minister. Yahya was a palace builder, a patron of artists, philosophers and scientists. He organized debates where thinkers and philosophers could expound their ideas and engage in verbal arguments. His sons, Jafar and Al Fadl, followed in the footsteps of their father as prominent public servants, before the family's fall from grace. Although Jafar was a confident and close friend of the caliph, Harun-al-Rashid (786 AD – 809 AD), suspicious of his power and influence, ordered his execution and the jailing of Yahya and Al Fadl (McMillan, 2013). The Persian influence did not end with the fall of the Barmakids. A Persian military commander, Afshin, led the armies of the caliphate under Mutasim (833–842), and was credited with the successful campaign to repress and defeat the rebellion of his fellow Iranian, Babak in 837 (Lewis, 1991), before being accused of apostasy and killed on the orders of the Caliph.

In sum, throughout history, Iranian influence in the arts, in the sciences, in religious, and philosophical ideas, as well as in military and civilian governance reached far and wide. One can argue that this influence continues to this day in one way or another.

## 1.6. Iran's Contribution to International Trade

Since time immemorial, trade among diverse human groups, tribes, or nations has contributed to economic prosperity and the dissemination of knowledge, arts, and beliefs. The development of trade, however, is dependent on favorable political conditions, the existence of basic infrastructure (roads, sea routes, financial means of payment, etc.) and a modicum of safety and stability. As a result of changing circumstances, Iran's trade with its neighbors and with countries further afield has ebbed and flowed. An example of these changing fortunes is the current economic isolation of the country, and many more exist throughout the country's long history. Once again, it is to this history that we must turn to demonstrate that far from being a marginal player in international commerce, Iran has been, and can to some extent aspire to be in the future, an important node of international trade relations.

Thanks to its strategic location at the cross-roads of several overland and maritime trading routes, Iran always played an important role in facilitating global trade and commerce. Iran was also an important entrepot for a number of commodities such as silk, silver and gold bullion, spices, sugar, and textile (Matthee, 2012). Iran also exported carpets, horses, goat's hair known as kork from the province of Kermān, pearls, different types of dried fruits, nuts, rhubarb, leather, rosewater, and wine (Encyclopaedia Iranica, 2015).

As described earlier, the Achaemenid kings established the first multinational state, ruling over a vast territory, unprecedented at that time. For over two centuries, the stability and peace achieved through imperial power and control, combined with the development of a network of roads, the construction of canals,



coinage of widely accepted means of payment, and the enforcement of laws and the administration of justice created the conditions to facilitate trade within the empire. During this period, international commerce developed too, in particular with Greece, notwithstanding the wars waged against Athens. The “Ancient Suez Canal,” also known as “Pharaohs’ Canal,” started by Achaemenid king Darius to link the Nile and the Red Sea became a conduit for maritime trade between the Persian Gulf and the Mediterranean Sea (Briant, 2006), where Greek merchants, who had replaced the Phoenicians as master seafarers, dominated international economic exchanges. Ships plied the southern sea lanes as well, linking Persia with India, from where the empire imported gold and ivory and exported wool, copper, iron, grain, etc. The conquests of Alexander and the rule of his successors ushered a period of strong Hellenic influence followed by the rule of the Parthian kings (247 BC – 228 AD). The latter was marked by a decentralized power structure that favored the development of independent city-states such as Hatra, Palmyra, and Babylon as centers of trade linking the Parthian territories to the Roman Empire. Trade links were established with China, marking the beginnings of what would become the famed Silk Road. With the revival of a centralized and powerful Persian empire rivaling the Achaemenids during the Sassanid empire (224 AD – 651 AD), trade relations with neighboring powers including India, China, and the Roman empire continued to develop (Daryaee, 2009). There were two major trade routes: the overland Silk Road, with Iran occupying a key geostrategic position at its center, linking China with the West, and the maritime road to India, Southeast Asia, and the southern coast of China. The Silk Road was a major axis for trade, contributing to the prosperity of desert towns such as Samarkand, Kashgar, and Turfan, where eastern Iranian culture (Sogdian) was dominant and communities of Iranian merchants settled along the road as well as in China. Anxious to circumvent the monopoly of Persian middlemen over the trade of the much coveted silk, the Romans attempted to develop a maritime route to China. For centuries The Silk Road continued to play a major role in international commerce. A famous merchant from Venice, Marco Polo, followed in the footsteps of countless caravans in traveling this ancient route. It was not until the fourteenth and fifteenth century, as European explorers began to reach the far corners of the earth thanks to new ship building technology, that the overland trade began to decline. In 1507, the Portuguese under the command of Alfonso de Albuquerque captured the island of Hormuz (in the strait of the same name at the entrance of the Persian Gulf). The island remained under Portuguese control for a century before being recaptured by the Safavid king Abbas 1st, with the help of the British. However, long before the first forays of European conquerors, Iranian navigators had plied the waters of the Persian Gulf, from where they reached the east coast of Africa, India, and beyond. During the Islamic period, ports such as Siraf or Bushihr, often built over existing cities dating to the Sassanid period, were bustling hubs of international trade. Pearls from the Persian Gulf were exported while porcelain was imported from China, spices from



India and wood from Africa. Communities of Iranian traders existed in major port cities of China, as well as in Siam (sixteenth and seventeenth centuries), India and Sri Lanka (*Encyclopaedia Iranica*, 2015). These expatriate communities played a major role in the dissemination of ideas and their native culture. An earlier migration of Persians, not traders but refugees, namely a group of Zoroastrians fleeing their native land in the face of increased persecution by Muslim rulers in the tenth century, led to the establishment of a community (the Parsees) in India. Over the last few centuries, the Parsees have played a prominent role as administrators and businessmen. Many have become patrons of industry and major firms, such as Tata Industries, have been created by members of this small but prosperous community.

The Safavid period in Iran (1502–1736) marks the last time the country rose to regional and even global prominence. The great Safavid kings successfully resisted Ottoman power and offered refuge to persecuted Shi'a from their powerful neighbors. They forged Iran's distinctive Shi'a identity. Arts and architecture enjoyed a revival and trade relations, especially with the newly emerging European powers were developed. About the same period, the Persianate Mughal Empire ruled India, and contributed in its own right to the dissemination of Persian culture and administrative practices. According to Matthee (2012), during Safavid rule, Iran's trade flourished throughout the "Eastern hemisphere from Japan and East Indies to India, from Central Asia to Russia and Scandinavia through the Volga route, and from the Arabian peninsula to Anatolia, and Western Europe via the Mediterranean as well as the Cape route" (p. 31).

After the Safavids' reign, Iran entered a period of decline and by the nineteenth century, it owed its moribund existence only to the rivalry between two major powers, Russia and Great Britain, for whom it constituted a buffer zone (Kazemzadeh, 1968). It was only after the discovery of oil in the early twentieth century that Iran started to emerge from the throes of decay and chaos. Following the example of Kemal Ataturk in neighboring Turkey, Reza Shah Pahlavi, a military leader who had crowned himself the autocratic king of a new dynasty, introduced modern forms of governance and far-reaching reforms. Decades later, it was Iran, under the leadership of Prime Minister Mosaddegh, who first championed, in the early 1950s, the nationalization of oil production and the renegotiation of lopsided agreements favoring Western interests. During those years of fervent nationalism, Iran was subjected to an embargo on its oil exports by Great Britain and its allies, before the latter resorted to the outright removal of the elected leader through a coup sponsored by US intelligence services (Kinzer, 2008). Later in the century, Iran was among the founding members of OPEC. Shortly before the revolution of 1979, the country enjoyed a few years of soaring oil revenues, under the leadership of an autocratic leader, Mohammad Reza Shah Pahlavi, a staunch ally of the West. For the last 36 years, however, the country has been subject to escalating sanctions, its economy atrophied and many of its citizens migrating to other countries. Today, the Iranian diaspora is spread around the world, from North America where a

community of half a million people of Iranian descent is thriving, to Europe and the Persian Gulf countries, especially the United Arab Emirates (UAE), where many Iranian businessmen and members of the middle class have found refuge, to India and Australia. Members of this diaspora are well positioned to serve as a conduit for trade and investment, should Iran reintegrate the world's economy. Finally, one must remember that Iran itself has profoundly changed since the 1979 revolution. Although its economy is severely constrained by sanctions, mismanagement and poor governance, it is still a relatively well developed country, internally stable and benefiting from a good infrastructure. Most importantly, it has a large and well educated population, eager to see their country recover what they consider its rightful place in the global economy.

## 1.7. Conclusion

At the time of writing this chapter, Iran and six international powers, the United States, China, Russia, Britain, France, and Germany, collectively known as P5 + 1, have been engaged in protracted negotiations that began in 2006 over Iranian nuclear programs. Leaders of both Iran and P5 + 1 countries are trying to reach a comprehensive deal by July 2015 that will prevent Iran from making nuclear weapons in return for easing/ending sanctions against Iran. The election of a reformist president in Iran gave rise to the hope of reaching a lasting agreement. While the outcome of the ongoing negotiations is difficult to predict, it is hoped that the increased interaction between the officials of the P5 + 1 countries and Iran would usher in a new chapter in the relations of Iran with the rest of the world.

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## Chapter 2

# Potential for the Expansion of Iranian Natural Gas Exports: Opportunities and Limits<sup>☆</sup>

Mahmood Monshipouri

### Abstract

Iran's potential to expand its natural gas exports has received a great deal of attention since Hassan Rouhani's election in 2013. Rouhani's presidency centered around adopting a foreign policy approach to actively promote a constructive engagement and dialogue with the West, as well as seriously pursuing diplomatic and prudent interactions with Iran's immediate neighbors and beyond on an equal footing with a view toward advancing mutual accommodation, respect, and shared interests. This chapter's central argument is that Iran's ability to export natural gas to Europe depends largely upon maintaining stable and strong trade ties with Turkey. The cooperation between these two countries, despite competition and occasional frictions, could arguably foster a balance of power at middle-power level countries that will be necessary for an enduring stability in the region.

**Keywords:** Natural gas; the EU; Turkey-Iran relations; middle power; nuclear dispute; regional security

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## 2.1. Introduction

Iran's potential to expand its natural gas exports has received a great deal of attention since Hassan Rouhani's election in 2013. Rouhani's presidency revolved around adopting a foreign policy approach to actively promote a constructive engagement and dialogue with the West, as well as seriously pursuing diplomatic and prudent interactions with Iran's immediate neighbors and beyond on an equal footing with a view toward advancing mutual accommodation, respect, and shared interests. Iran's Foreign Minister Mohammad Javad Zarif aptly captures this central theme:

The main vehicle for this campaign is the “crisis” over Iran's peaceful nuclear program — a crisis that, in Iran's view, is wholly manufactured and therefore reversible ... Iran has no interest in nuclear weapons and is convinced that such weapons would not enhance its security. Iran does not have the means to engage in nuclear deterrence — directly or through proxies — against its adversaries. Furthermore, the Iranian government believes that even a perception that Iran is seeking nuclear weapons is detrimental to the country's security and to its regional role, since attempts by Iran to gain strategic superiority in the Persian Gulf would inevitably provoke responses that would diminish Iran's conventional military advantage. (Zarif, 2014)

The early success in the negotiations between the “P5 + 1” group and Iran has generated an atmosphere noticeably conducive to a comprehensive agreement that will ensure nonproliferation, recognition of the Iran's peaceful civilian energy program, and the lifting of sanctions on Iran. A central and yet unresolved question remains: will the divide between Iran and the West narrow on the former's role in becoming integrated into oil and gas international markets? To answer this question, it is important to acknowledge certain facts. Although European demand for gas remains relatively weak, Asian nations like Japan, South Korea, China, and India are all expected to rapidly increase their liquefied natural gas (LNG) imports over the next decades. A growing proportion of the Persian Gulf's LNG is likely to be shipped eastward (Ford, 2013).

Furthermore, the availability of LNG and the discovery of shale resources in Europe have posed threats to Gazprom's position. As LNG shipments to Europe rise significantly, Russian gas exports drop noticeably. For Russia, trade and commerce with Arab countries of the Persian Gulf have now assumed much more significance than they did in the past (Oskarsson & Yetiv, 2013). Added to these realities is the impact of a potential longer-term agreement with Iran and its ramifications not only for providing short- to medium-term relief on Tehran's energy concerns, but also for the expansion of Iran's regional and global natural gas markets in the future. Unlike oil markets, natural gas markets are regional rather than global in nature, generally with very limited formal connections between markets. Iran is strictly a regional exporter of natural gas via pipelines to three neighboring countries — Turkey, Armenia, and Azerbaijan (US Energy Information Administration, 2012). But what gives Tehran an added advantage is the fact that the transportation

cost of Iran's natural gas to the EU is much lower than those delivered from Central Asia, Russia, and the rest of the Middle East.

It should be noted, however, that Iran's internal problems: poor infrastructure, inadequate technological capacity, the lack of conducive environment to foreign investment, factionalized political economy, and mismanagement; present a major hurdle to the expansion of Iran's natural gas exports, even if a broader agreement were to be achieved within the "5+1" framework. This paper's central argument is that Iran's ability to export natural gas to Europe depends largely upon maintaining stable and strong trade ties with Turkey. The cooperation between these two countries, despite competition and occasional frictions, could arguably foster a balance of power at middle-power level countries that will be necessary for an enduring stability in the region. The regional security concerns of the United States in the Middle East will also be positively impacted by an offshore balancing strategy that renders such cooperation sustainable.

## **2.2. Iran's Natural Gas Reserves in Perspective**

Since the advent of the oil age in early twentieth century, as experts point out, Iran's enormous hydrocarbon resources — the world's third-largest producer of crude oil and second-largest holder of natural gas reserves — have underlined its strategic importance. Between its natural gas and its petroleum reserves, the country's hydrocarbon resources are effectively equal to those of Saudi Arabia and significantly greater than those of Russia (Leverett & Leverett, 2013). The three countries of Russia, Iran, and Qatar together hold nearly half the world's proven gas reserves. Iran holds the world's second-largest reserves of natural gas, but the vast majority of these reserves remain undeveloped. Iran's proven gas reserves of 1187 trillion cubic feet are second only to Russia's 1688 trillion cubic feet, according to January 2013 figures published by the US Energy Information Administration (EIA, 2013).

Iran's gas reserves are estimated 33.6 trillion cubic meters and its untapped gas reserves comprise 17.7 percent of total world gas (US Energy Information Administration, 2013). Eighty percent of Iranian natural gas reserves, according to one source, are located in non-associated fields, and most of these reserves have yet to be developed (Tagliapietra, 2014). Iran's natural gas reserves are largely located in the offshore Persian Gulf, although considerable associated natural gas production comes from the country's onshore oil fields (Tagliapietra, 2014). Major natural gas fields include: South Pars, North Pars, and Kish. Other promising natural gas fields include the Tabnak field, the Kangan-Nar fields, and Dalan and Aghar fields. In 2011, Iran produced and consumed the same quantity of natural gas — that is, an estimated 5.4 Tcf of dry natural gas (Tagliapietra, 2014). Other sources have shown that Iran's production (151.8 Bcm) falls short of its consumption (153.5 Bcm) in 2011 (Carter, 2014).

The giant South Pars gas field, only a portion of which is in Iranian territory, comprises over 27 percent of Iran's total proven natural gas reserves and is Iran's largest natural gas field (US Energy Information Administration, 2013). Another valuable reserve is comprised Natural Gas Liquids (NGL), which needs not be pressurized or refrigerated in order to become liquids like liquefied natural gas (LNG). The cost of its extraction, storage, and transit are relatively low compared with LNG. Iran does not publish official data for condensate and other NGL production (International Energy Agency, 2010).

As noted above, most of Iran's reserves are undeveloped, and the country cannot even supply its own needs. According to the EIA, since 2000 Tehran has often imported more gas than it has exported. Experts remind us that it might take decades before Iran could develop an optimal level of production, build an infrastructure, remodel its domestic market, and become a key producer in the international LNG market. Furthermore, if the Southern Corridor is expanded to accommodate Iranian gas, it could develop a larger feeder to Eastern European markets that are now exclusively supplied by Russia (Max, 2014). It is clear that unless sanctions are lifted and the US and EU companies are willing to invest in developing Iran's gas fields and financing such projects, Iran is unlikely to reach its potential as a major gas exporter.

Successful negotiations between the "P5+1" group and Iran appear likely to pave the way for concluding a comprehensive deal, unlocking Iran's potential to expand its natural gas exports. This eventuality could strain Iran-Russia relations if it means Europe will become less dependent on Russian gas. European countries that have long sought a reliable and viable alternative to Russian energy, especially its natural gas, will most likely give the Iranian option serious consideration. More than 90 percent of Russian natural gas and 80 percent of its crude oil exports, find their way to the European Union (EU). This accounts for nearly 50 percent of Russia's federal budget (Vakhshouri, n.d.). Europe currently obtains 36 percent of its gas and 20 percent of its oil from Russia (Wiess, 2013). Natural gas accounts for 40 percent of Ukraine's total energy consumption — of which more than half comes from Russia. Before the annexation of Crimea, Ukraine was receiving more than a 30 percent discount on Russian gas, and was also excessively dependent upon Russian crude oil (Vakhshouri, n.d.).

### ***2.2.1. South Pars Gas Field***

The Supergiant South Pars is the most important gas field in Iran. In 2008, it produced 52.7 Bcm, nearly 35 percent of the total non-associated gas production in the country (Adibi & Fesharaki, 2011; see especially p. 277). This field is designed to be developed in 26 phases (Adibi & Fesharaki, 2011, p. 278). It now can produce about 9 bscfd of gas from 10 phases and has 14 phases under development. All but five nonproducing phases are in early stages and unlikely to be on stream before 2020, *Facts Global Energy* (FGE) reports. Likely to come onto production in the next

3–4 years are Phases 12 and 15–18. They would boost production by 7 bscfd and 280,000 b/d of condensate ([Oil and Gas Journal, 2013](#)). Phase 12, development of which is the most advanced of the five, ultimately will be 3 bscfd of gas and 120,000 b/d of condensate. The first of six sweetening trains for Phase 12 will start up by mid-2014, FGE says, allowing production of 500 MMscfd. Other trains will be on stream by 2015. National Iranian Oil Co (NIGC) has installed the first production platform in Phase 12 and drilled six wells ([Oil and Gas Journal, 2013](#)).

Phases 15 and 16, under development for 74 months, probably will require 2 more years of work before production can start, FGE says. They're expected to produce 2 bscfd of gas and 80,000 b/d of condensate. Phases 17 and 18 have a total of 11 wells out of 44 wells planned. Remaining drilling will take at least years, FGE says. One gas sweetening train for these phases might be complete next year, but construction of others will require 2–3 years. The phases are expected to produce 2 bscfd of gas and 80,000 b/d of condensate ([Oil and Gas Journal, 2013](#)).

The North field, by contrast, contains sour and lean gas reserves. Except for some initial offshore development work in the 1970s by Oil Services Company of Iran (OSCO), it remains underdeveloped and the field is located in the Persian Gulf. In December 2006, National Iranian Oil Company (NIOC) and China National Offshore Oil Company (CNOOC) signed an agreement to develop the North Pars natural gas field and export 20 Mt/ye of LNG ([Adibi & Fesharaki, 2011](#), p. 283).

## **2.3. Gas Market Outlook and Strategy**

Over the past decades, several commercial and geopolitical barriers have made Iran a net importer of natural gas despite its rich natural gas reserves. Following a long-term agreement with the “P5 + 1” group on its nuclear program, Iran will undoubtedly explore several potential opportunities and constraints, as its gas industry looks for expansion of the country's export operations. If the dispute over the Iranian nuclear industry is settled, Iran has the potential to export 3–4 bscfd of gas by pipeline to neighbors such as Oman, the United Arab Emirates, Kuwait, Pakistan, and Iraq ([Prospects Improve for Pipeline Gas Exports by Iran, 2014](#)). Each of these opportunities faces many potential setbacks. In the sections that follow, we examine the present and future opportunities, with an eye toward examining Iran's strategy for the development of its gas sector in the coming years and decades.

### **2.3.1. Iran-Pakistan (IP) Pipeline**

Pakistan's dire energy needs are increasingly overshadowing the sanctions regime. The extension of the IP pipeline from Iran, to southern Pakistan to China's western provinces seems an option worthy of particular attention. The most logical pipeline for China is to use Pakistan as an energy bridge for Iran's natural gas. Yet, the



financing of this project and importing natural gas through the IP pipeline will pose a direct challenge to Washington's sanctions. Working against this idea is the growth of the LNG trade and the evidence of large unconventional reserves of both coal-bed methane (CBM) and shale gas throughout China (Carter, 2014). Faced with the political constraints of sanctions, Iran's LNG projects are unlikely to develop in the near future, rendering Iran unable to exploit a potential growing market share. It appears that the growing demand in Asia for natural gas can, at least in the short to medium term, be met by other LNG producers such as Qatar, Australia, and Indonesia (Carter, 2014).

Over the longer term, however, an effective strategy could lead to the completion of the Iran-Pakistan pipeline, provided that Pakistan fulfills its side of the deal. Pakistan's lack of funds has thus far postponed the completion of this project. When operative, this pipeline could be seen as a front-runner project in the future Iran's natural gas export strategy. Surely, an added value of this project will be the potential for extending the pipeline to India, a country that most likely will dramatically increase its natural gas consumption and imports after 2030 (Tagliapietra, 2014). It should be noted that Iran and Pakistan signed an agreement in 1995 over the construction of the IP gas pipeline — also known as the Peace Pipeline. Subsequently, Iran made a proposal to extend the pipeline from Pakistan into India. In February 1999, Iran and India signed an accord to that effect. But because of US pressure and its sanction policy, India withdrew from the project in 2009.

On May 4, 2013, however, Indian Minister of External Affairs Salman Khurshid voiced New Delhi's willingness to reenter negotiations over the IP gas pipeline project. "If there is seriousness from all sides," Khurshid has said in New Delhi on January 29, "we are ready to import natural gas from Iran and Central Asia through Pakistan" (Islamic Invitation Turkey, 2014). The United States has continuously threatened Pakistan with economic sanctions if Islamabad went ahead with the IP pipeline project. In response, Pakistan's leaders have made it clear that addressing the country's enduring energy problems will be their top priority, and that they have no plans to reverse the decision on the completion of the IP pipeline. The IP pipeline is certain to help Pakistan overcome its growing energy needs at a time when the country of over 180 million people is wrestling with serious energy shortages (Islamic Invitation Turkey, 2014). At the same time, Iran can reverse the trend of importing gas, given that its imports from Turkmenistan exceeded its exports to Turkey and the Caucasus, by jumpstarting the Iran-Pakistan pipeline past 2015 (Adibi & Fesharaki, 2011, p. 302).

Likewise, Bangladesh, which has a natural gas deficit and will have to import gas at some point in the near future, has also shown its interest to join this pipeline project. Bangladesh's Minister of Finance Abu Maal Abdul Muhith has expressed his country's deep interest in joining this multi-billion-dollar project by saying: "If (the) Iran-Pakistan gas pipeline is expanded up to India, we can join it. Joining Iran-Pakistan-India natural gas pipeline project would give Bangladesh access to Iran's gas and resolve its energy crisis" (Islamic Invitation Turkey, 2013).

It is nevertheless important to acknowledge the limits to this project given the lingering enmity between India and Pakistan over the unresolved status of Kashmir. For its part, India appears keen on developing a transit route connecting Afghanistan to Iran's newly developing Chabahar port. Located on the Makran coast in the southeastern province of Sistan and Baluchistan, Chabahar is Iran's first and only deep-water port that directly faces the Indian Ocean. Not too far (44 miles) west of Pakistan's deep-water port of Gwadar, which was built with Chinese assistance, Chabahar could provide the opportunity to enormously boost trade between India, Iran, and Afghanistan. Moreover, strengthening Afghanistan's economic and trade ties by connecting the landlocked country to the Indian Ocean and beyond could further advance regional stability. In India, as one expert notes, there is a growing urgency to prioritize the country's engagement with Iran (Sumitha, 2014).

### ***2.3.2. Iran-Turkey Pipeline***

Turkey, by contrast, is a large importer of Iranian natural gas and presently one of Iran's most important trading partners. In the past, the energy deals between Iran and Turkey have not been prevented by the US sanction policies, most notably the Iran and Libya Sanctions Act of 1996. In fact, Turkish Prime Minister Necmettin Erbakan's first foreign visit to Iran in August 1996 resulted in the signing of a \$23 billion natural gas deal and an agreement for the construction of a pipeline (Elik, 2011). This contract was accepted by Washington, because the deal involved no direct investments in Iran by either Turkey or other Western countries (Elik, 2011, p. 167). In July 2007, Iran and Turkey signed a Memorandum of Understanding (MoU) that would pave the way for \$3.5 billion worth of Turkish investment in Iran's South Pars gas field on a buyback basis (Elik, 2011, p. 167). In 2008, Iran exported only 4.2 Bcm of gas to Turkey. Gas supply shortages within Iran prevented further export to Turkey (Adibi & Fesharaki, 2011, p. 289). It is worth noting that the Iran-Turkey pipeline has at times been sabotaged by the PKK terrorists (Adibi & Fesharaki, 2011, p. 289).

The interest-driven relationship between Iran and Turkey has continued unabated, even as periodical events, such as US interventions in Afghanistan (2001) and Iraq (2003), the ensuing 2011 Arab uprisings, and Syrian civil war have presented economic, political, and security complications (Stein & Bleek, 2012; see p. 144). Increased trade and cooperation have helped establish more robust diplomatic ties between Ankara and Tehran, while at the same enhancing Turkey's role in facilitating talks between Iran and the United States for the purpose of resolving the nuclear issue (Stein & Bleek, 2012, p. 139). In 2010, then Prime Minister Recep Tayyip Erdoğan and his Brazilian counterpart, Lula da Silva, succeeded in getting Iran's acceptance for a nuclear swap deal. Although this diplomatic victory was rejected by the Obama administration at the time, 3 years later, Iran and the United States agreed to an interim deal (Parsi, 2014).

Since 2013, the two countries have aimed to increase their trade volume to \$30 billion by 2015 (*Tehran Times*, 2013). Historically, bilateral trade ties between Iran and Turkey have been grounded in practical necessities and have thus resumed with a modicum of certainty. The two countries have been at peace since 1639, when Safavid Iran and the Ottoman Empire signed the Treaty of Zuhab, which recognized and subsequently placed what is known as present-day Iraq under the sovereignty of the Turkish Ottomans (Elik, 2011, p. 174). In addition to the growing relationship between the two countries, Turkey has sought to become the region's natural gas export hub, holds a great potential as a transit nation for Iran's natural gas bound for Southern and Eastern Europe (Carter, 2014). In 2012, Iran's exports natural gas to Turkey via the Tabriz-Dogubayazit pipeline amounted to 7.5 Bcm. Iran supplies upwards of 30 percent of Turkey's natural gas needs (Peterson, 2014), making Iran Turkey's second largest supplier of natural gas imports after Russia, which make up about a 60 percent share of Turkey's natural gas imports (Tagliapietra, 2014).

Three major legislative problems, as one expert observes, have thus far created a barrier to Turkey's energy hub initiatives: (1) the economic sanctions against Iran, (2) the legal status of the Caspian Sea, and (3) Turkey's energy legislation for liberal marketing. Were these problems solved, Turkey would play a substantial role in transporting Turkmenistan's and Iran's natural gas to Europe (Elik, 2011, p. 158). The Iran-Turkey natural gas pipeline can be extended to the Caspian Sea shore (Elik, 2011, p. 158). Without Iran, however, Turkey's access to the Caspian natural gas will be limited (Elik, 2011, p. 159). The Iran-Turkey pipeline can arguably be a reliable transportation route insofar as the EU energy security is concerned. It should be noted that the only way that Turkmenistan natural gas can reach Europe is via Russia, Iran-Turkey, or Azerbaijan-Georgia-Turkey routes (Elik, 2011, p. 160).

Since the interim agreement between Iran and the "P5 + 1" group on the former's nuclear program, the Turkish government has quietly intensified its efforts to reach an agreement with Iran to build the Iran-Turkey-Europe Natural Gas Pipeline Project (ITE) in an attempt to convey Iranian natural gas to Europe via Turkey. The history of the pipeline can be traced back to an Agreement Protocol signed on November 17, 2008 between the Iranian Ministry of Oil and the Turkish Energy and Natural Resources Ministry for transit passage of the natural gas source in Iran through Turkey. The total length of the ITE pipeline is about 5000 kilometers (3107 miles), approximately 1750 kilometers (1087 miles) of which will be in Turkey (Turkey Seeks to Build Iran Pipeline Amid Uncertain Environment, 2014).

The countries of the south Caucasus, namely Armenia and Azerbaijan, have relied on Iran's gas exports but their imports fail to prompt a huge expansion of Iran's natural gas exports. Armenia receives approximately 20 percent of its natural gas imports from Iran, using a great bulk of this natural gas to generate electricity at the Hrazden power plant. In exchange, the Armenia Nuclear Power Plant (ANPP) exports electricity to Iran generated from this plant. It is estimated that Armenia supplies 3 kilowatt-hours of electricity for every cubic meter of natural gas

it receives from Iran (Tagliapietra, 2014). Iran also exports natural gas to the isolated Azerbaijani enclave of Nakhchivan via the Salmas-Nakhchivan pipeline. Azerbaijan repays Iran by exporting natural gas to Iran's northern provinces in exchange for electricity. This gas deal has been possible via the Astara-Kazi-Magomed pipeline. Nakhchivan's sole supply source of natural gas is Iran (Tagliapietra, 2014). Azerbaijan and Iran also maintain their cooperation in the transport of Caspian Sea oil as well as Iranian oil to the Turkish port by using the Tabriz-Ankara pipeline (Elik, 2011, p. 146).

To fulfill these commitments, as well as meet its domestic natural gas consumption, Iran imports natural gas from Turkmenistan. In 2012, Iran imported 9 Bcm of natural gas from Turkmenistan, accounting for about 30 percent of all Turkmen natural gas exports. This economic relationship was reinforced by the completion of the Dauletabad-Hasheminejad pipeline. These imports are currently integral to Iran's ability to meet both season peak demand and industrial demand in northern Iran (Tagliapietra, 2014). Turkmenistan's pace in supplying gas to Iran and China has risen dramatically in recent years. Iran has become heavily dependent on Turkmen gas imports until 2015 given that all new Iranian gas projects, especially those in the South Pars field, have been delayed. This situation has allowed Turkmenistan to set a price in line with European market prices for these countries (Elik, 2011, pp. 147–148).

It is now a generally agreed-upon fact that Caspian Sea hydrocarbon sources have the necessary capacity — especially if they include Iran's natural gas — to provide Europe, Russia, China, and Iran with gas. Europe's main obstacle is the lack of a reliable transportation route. Given Turkey's unique location between the countries that hold over 70 percent of the world's oil and gas reserves to its East, North, and South, it can develop to become a major European energy hub. Some experts have defined Turkey's role as an “interconnector” and bridge between the region and Europe (Elik, 2011, p. 160). It is in this context that the importance of the Iran-Turkey pipeline is underscored. Turkey is acutely cognizant of the significance of its trade ties with Iran. In 2008, as Suleyman Elik observes, Turkey effectively dealt with the global financial crash by structurally changing its strategic economic opening toward the Middle East, especially Iran. Should these two countries successfully build a constructive relationship in the economic, security, and energy domains, Elik concludes, they could contribute substantially to peace and stability on a regional level (Elik, 2011, p. 175). The alternative to Iran-Turkey Pipeline is a pipeline that passes through Iraq, Syria, Lebanon and eventually the Mediterranean Sea. The undersea route passing beneath the Mediterranean Sea presents yet another alternative, but none are admittedly more cost-effective than the Iran-Turkey pipeline.

Iranian President Rouhani's visit to Ankara (June 9–10, 2014) demonstrated that despite some ideological differences and regional competition, economic relations — energy and trade — continue to be a key priority for both countries, as they want to double the value of bilateral trade to \$30 billion by 2015 (Peterson,

2014). Iran seeks a conduit to engage in trade with the outside world, and Turkey serves as such channel. The extent to which both sides have curbed their dispute over Syria is remarkable, and is underpinned by vital economic and infrastructure ties (Brown, 2014). In the long term, however, experts argue that perhaps the most important spot for Turkey-Iranian competition will prove to be post-Saddam Iraq. With the US exit from Iraq and the increasingly independent Kurdistan Regional Government in northern Iraq, the Turkish-Iranian competition will most likely intensify (Armstrong, n.d.).

### ***2.3.3. Proposed Iran-Oman Pipeline***

In March 2014, according to one source, Iran signed a 25-year agreement to supply 10 Bcm of natural gas per year to Oman, beginning in 2017 (El Baltaji, 2014). Other sources have pointed out that Iran will be unable to complete the infrastructure required to support the Omani exports before 2018–2019 at the earliest (Prospects Improve for Pipeline Gas Exports by Iran, 2014). They argue that the countries have not yet agreed on the gas price, which Iran wants to be \$11–14/MMbtu, while Oman seeks \$6–7/MMbtu. This gas deal requires the construction of a 260 km-long subsea pipeline from Iran's Hormozgan Province to Oman's Sohar port on the other side of the Persian Gulf. Oman, which already imports natural gas from Qatar, plans to build this \$1 billion natural-gas pipeline. Oman, which has often pursued a discreet, but equally non-conformist, foreign policy within the context of the Gulf Cooperation Council (GCC), has publicly rejected the Saudi-proposed Gulf Union (Janardhan, 2014). This development is the latest and most obvious sign that Saudi Arabia has failed to bind its smaller members of the Gulf Cooperation Council (GCC) into a tighter bloc united in hostility toward the Islamic Republic of Iran (El Baltaji, 2014).

According to the deal, the two countries have the option of forging a joint venture to export the natural gas. This should not come as surprise given the history of cooperation between the two countries. In the past, Iran and Oman have on several occasions discussed the opportunity of bringing Iran's natural gas to Oman's under-utilized LNG export facility, a possibility that could result in establishing Oman as a new hub for future Iran's natural gas exports (Tagliapietra, 2014). This plan would entail keeping about 30 percent of the natural gas export to Oman as Iran's natural gas to be processed into LNG by Oman under a tolling agreement, allowing it to be sold in international markets. This project could very well represent the first move of Iran into global LNG markets (Tagliapietra, 2014).

The Iranian Ambassador to New Delhi, India, Gholam Reza Ansari has stated that India's South Asia Gas Enterprise (SAGE) has conducted feasibility studies for the planned 1400-kilometer pipeline, which is estimated to cost \$4–5 billion and would carry 31 mcm per day of gas to India. Iran has in principle agreed to export natural gas to India through a deep-sea pipeline crossing the Sea of Oman. The projected pipeline will carry gas from Iran's vast South Pars oil and gas field

(PressTV, n.d.-a). If and when this pipeline is built, as experts note, it would likely have a noticeable effect upon LNG shippers in the Indian Ocean region as well as a tangible impact on plans for regasification facilities offshore India's coast (Almeida, 2014).

### ***2.3.4. The Abandoned Nabucco Pipeline Project***

The Nabucco pipeline project, which was supposed to have transported gas from the Caspian Sea to Europe in order to bypass Russia, became defunct due to many geopolitical and commercial reasons, most notably political tensions and exorbitant rise in construction costs. Some Iranian experts have argued that without Iranian participation, the project has lost some of its viability. New Iranian leadership has become increasingly cognizant of the important role that Turkey and the Republic of Azerbaijan are playing as the key countries that maintain control over the Trans-Anatolian gas pipeline (TANAP).

Iran must engage in close cooperation with Turkey and the Republic of Azerbaijan, whose cooperation would enable Iran to connect the existing Iran-Turkey gas pipeline to TANAP, whenever Western imposed sanctions are lifted. But the question arises as to whether the crisis over Ukraine will galvanize Europe into action in order to seriously follow up on the implementation of the Nabucco pipeline project (Iran and Russia-Ukraine Crisis: Natural Gas Exports and New Regional Opportunities: Analysis, 2014). Ultimately, however, the Nabucco project, if it ever came to pass, is bound to hamper Russian energy hegemony, while at the same time remarkably boosting cooperation between Iran and Turkey — a collaboration which is key to peace and stability in the region (Elik, 2011, p. 175).

President Rouhani was the first Iranian leader to address the annual business summit (World Economic Forum, January 22–25, 2014) in the Swiss resort of Davos in a decade. Rouhani was clear in his message that Iran is looking forward to working with the West: “The Islamic Republic of Iran is prepared to engage in constructive cooperation for promoting global energy security, drawing on its vast oil and gas resources” (Max, 2014). Rouhani went on to hold a meeting with executives of BP PLC, Italy's Eni SpA, Royal Dutch Shell PLC, Saudi Arabia's Aramco, and France's Total SA.

## **2.4. Limits to Iran's Gas Exports**

Several internal and external factors have contributed to limit Iran's potential to expand its gas exports. Externally, both the EU and US sanctions on Iran's energy sector prohibited investment in and technological support for Iran's oil and gas industry. Additionally, the United States denied contracts and finance to firms conducting business in Iran (Jalilvand, 2013). The most serious setback to Iran's gas

industry, however, comes neither from the lack of foreign investment nor from sanctions on the energy industry, but rather from domestic factors. Iran's factionalized political economy limits the state's ability to stay above factional politics and rivalries. Subsidies and increased domestic consumption have turned Iran into a net importer of gas with no gas left for exports (Jalilvand, 2013, p. 15).

Moreover, objections to foreign participation, which are typically political in nature and characterized by a lack of a detailed strategy, present yet another obstacle. While buyback contracts are encouraged and production sharing arrangements are discouraged, these arrangements constitute a much lower barrier on the whole than the politicized nature of Iran's political economy that dampens Iran's long-term prospects for exporting gas. It is this politicized context that poses a serious barrier to concluding long-term contracts, while undermining Iran's reliability as a trade partner (Jalilvand, 2013, p. 20).

To create a sufficient export capacity, Iran needs to implement subsidy reform, gain access to Western markets and technologies, as well as LNG technologies, and increase its production, while making a greater share of gross production marketable. The removal of government subsidies on energy, food, and medicine has proven to be, both economically and politically, a risky undertaking. At an estimated cost of \$40–100 billion annually, these subsidies — in place since the 1980s — have strained government funds and supported inefficient energy use (Tehran Bureau, 2014). While the Rouhani administration has pushed forward with the liberalization of energy prices, it continues cash handouts, which have become a lifeline for the poor and unemployed. As of April 2014, the amount of the monthly cash payout to each applicant has remained unchanged at 45 thousand tomans (less than \$15), financed by the removal of about 48 thousand billion tomans (\$16 billion) in energy subsidies (Tehran Bureau, 2014). Nearly 73 million people have applied for the phase-two subsidies, and over half of them have declared monthly income below \$300 (Tehran Bureau, 2014).

To liberalize its energy policy, Iran must rationalize its gas sector in order to win export contracts from foreign customers. This rationalization requires that Iran refrains from using gas contract negotiations as an arena for settling domestic political struggles between the Parliament, the executive branch, and non-governmental organizations tasked with the redistribution of the national wealth. Given these impediments, it appears likely that by 2025 Iran would be in a position to increase its natural gas exports up to a level of perhaps 20–30 bcm/y in the best case scenario (Jalilvand, 2013, p. 24).

## 2.5. The Crisis over Ukraine

In the late 1990s, Zbigniew Brzezinski wrote about the emerging balance of power in Eurasia, arguing that whoever rules Eurasia, will control the destiny of the world



(Brzezinski, 1997). This was in large part because, Brzezinski went on to note, Eurasia accounted for 75 percent of the world's population, 60 percent of its GNP, and 75 percent of its energy resources (Brzezinski, 1997, p. 50). A power that dominated Eurasia would exercise crucial influence over two of the world's three most economically productive regions: Western Europe and East Asia (Brzezinski, 1997). This strategy came to be known as the "Silk Road Strategy" (SRS). In May 1999, the US Congress passed the "Silk Road Strategy Law," which became popularly known as the "New Great Game." The law describes the US interest in Central Asia in the post-Soviet period. Along this line, NATO expansion was encouraged. Thus, support for Georgia and subsequently Ukraine membership in NATO became part of the agenda of controlling the energy and transport corridor from the Caspian Sea basin to Europe.

The Silk Road Strategy became the locus of important energy sources, present and possible transit routes, and was also intent on reducing the US dependency upon oil from the Persian Gulf region. Although the importance of overland pipelines is diminishing in the wake of the expansion of LNG trade and the revolution in unconventional natural gas, known as shale gas, they remain important to the present and future network of the natural gas trade. There are currently many natural gas pipelines in Europe and Eurasia that are essential to Open Joint Stock Company Gazprom's (known in Russia as Открытое Акционерное Общество «Газпром») or OAO gazprom's exports to Europe (Carter, 2014).

Post-Soviet Russia watched all these developments from a weakened and sidelined position. In 2008, the Russian Federation attacked Georgia and in 2014 it interfered in the Crimea in response to explicit outside meddling by the EU in support of the Ukraine's potential political membership. The collapse of the pro-Russia government in Ukraine and the West's continued support for the incoming government in Ukraine led to the upsurge of nationalist sentiments among the Russian residents of Crimea. The subsequent Russian intervention in Crimea, followed by the March 16, 2014 popular referendum in Crimea, resulted in the annexation of Crimea by Russia.

To better understand Putin's stand, it is important to realize what provoked this annexation. In the post-Cold War era, according to Andrei P. Tsygankov, the US approach to Russia has proven downright insulting, as evidenced by the US deployment of elements of a missile defense system in Europe and continuing expansion into Eurasia. The February 2014 revolution in Ukraine in violation of the agreement reached by Ukrainian President Viktor Yanukovych and the opposition dramatically ended all hopes of the normalization of relations between the United States and Russia (Tsygankov, 2014). Under such circumstances, Tsygankov observes, Putin had to rely on unorthodox and asymmetrical tools to preserve the balance of power in Ukraine. One such tool that was utilized was the annexation of Crimea, an act that allowed Putin to secure the future of the Black Sea Fleet and fortify the country's geopolitical position. The other tool that Moscow subsequently used was military deterrence aimed at Kiev, a policy that led to massing thousands



of troops on the east Ukraine border. While the Kremlin has no plan to invade Ukraine, Tsygaankov went on to say, it hopes its deterrence strategy could positively affect the future negotiations between Kiev and its eastern provinces. Keen on preserving its influence in Eurasia, Moscow is bound to rely on such asymmetrical tools (Tsygankov, 2014).

Perhaps, one of the most direct effects from this crisis and the lingering tension over Ukraine could be in reshaping Europe's energy policy. It is in this context that the EU's awakened interest in reducing its problematic dependence on Russian gas needs be understood. Over the years, Europe has moved toward diversifying its energy sources. This crisis has underscored the need to earnestly resume that process (Llana, 2014). The continuation of the tensions between Russia and European countries over Ukraine could fundamentally alter the dynamics of global energy markets, holding serious ramifications for global energy security. It is worth noting that Russia exported 86.1 billion cm of gas to 15 European countries through Ukraine in 2013. During that period, Italy was the largest recipient of the Russian gas that accounted for 25.3 billion cu. m. of gas or about 30 percent of the total gas imported to Europe from Russia. Italy was followed by Turkey and Germany, which imported 13 billion cu. m. and 11.7 billion cu. m. of gas from Russia, respectively (Pashang, 2014).

Thus far, EU member states have been reluctant to consider Iran as an alternative supply source to their heavy dependence upon Russia's natural gas and oil because of pressure applied by the US and the UN sanctions regime imposed on Iran. Emphasizing the need for Iranian oil and gas in international markets, some experts have noted that the sanctions against Iran have minimized the West's leverage against Russia's Vladimir Putin (Pillar, 2014). Others see the possibility for exporting gas to Europe as an immensely valuable and unique opportunity to enhance Iran's bargaining power within the context of the "P5+1" negotiations with the West. They argue that, given its huge natural gas reserves, Iran appears to be in a good position to export gas to Europe through pipeline and also in the form of LNG. As such, they note, the Islamic Republic will be able to serve as part of the EU's solution for the diversification of its gas supply sources. If this scenario unfolds, Turkey can serve as the transit route to take Iran's gas to Europe and, at the same time, supply part of the gas that Ankara needs to meet the country's domestic demand (Pashang, 2014).

Others cite basic problems of infrastructure and the lack of facilities to produce LNG or the means to export them as presenting major problems for Iran. They argue that it is unlikely that natural gas from Iran's fields will be flowing to the Asia and/or EU member states in the next decade, or perhaps longer. It appears, they insist, that Asian demand can, at least in the short to medium term, be met by other LNG producers such as Qatar, Australia, and Indonesia (Carter, 2014). Still others argue that Iran and Qatar, despite chronic friction, share the South Pars/North Dome field, together managing enormous gas reserves that offer an attractive alternative to the EU member states. For Qatar, this option is equally attractive because,

as experts observe, the country has since 2007 earned more from gas exports than from oil exports and is currently the world's largest exporter of liquefied natural gas (Kamrava, 2013).

## **2.6. Reorienting US-Iran Strategy**

Strategic interests and logic, Stephen Kinzer astutely remarks, are pushing Iran, Turkey, and the United States together. These countries can be logical partners in their desire to foster stability in the region and safeguard the long-term transportation of oil and natural gas to Europe. More specifically, in the case of US-Iran relations, Kinzer asserts that both these countries want a stable Iraq, Afghanistan, Lebanon, and Pakistan. Both detest radical Sunni movements like al-Qaeda and the Taliban. Iran needs massive investment in its collapsing energy infrastructure; American companies are ideally placed to provide it. If the United States fails to invest in Iran's oil and natural gas reserves, Russia and China will, thereby increasing their strategic leverage in the region (Kinzer, 2010). Kinzer wrote these words well before Hassan Rouhani became Iran's president in June 2013, and thus prior to the interim deal on Iran's nuclear program.

In the meantime, the greater challenge for the US foreign policy became synonymous with finding a new approach for the future of Asia. The Obama administration signaled its appreciation of US interests in Asia by announcing plans in late 2011 for a strategy of "rebalancing" (Markey, 2014). At the heart of this strategy, also known as the "Asia pivot," lies the relationship with China. The United States therefore, follows an enduring interest in strengthening alliances with states like Japan, South Korea, Australia, Malaysia, the Philippines, and cultivating partnerships with other states like Vietnam and Singapore, both on their own particular merits and in part as a means to improve US leverage with Beijing (Markey, 2014, p. 7).

China's growing military strength in recent years has spawned a number of territorial conflicts. The most serious involve uninhabited islands in the East China Sea, which Japan controls as the Senkakus and that China calls Diaoyu. Vietnam, Singapore, and Malaysia are also disputing China's expansive claim to the South China Sea and its energy resources. The Philippines has also filed a complaint against China with an international arbitration panel over its expansionist policies. China and South Korea have also tussled over rights to a submerged formation that China calls the Suyan Rock and South Korea dubs as the Ieodo (Lynch, 2014). Regional conflicts regarding the role of natural resources seem to be imbuing old fights with new conflict patterns. China's increasing dominance and the response by smaller states, seems to portend the greater merits of Obama's Asian Pivot.

The South China Sea has increasingly become a focal point for US-China rivalry in the Western Pacific. The United States could face the prospect of exclusion from this region, which is why the Obama administration has little choice but to assert its

interest in the South China Sea (Buszynski, 2012; see p. 152). Given this announced pivot — or rebalancing — toward Asia, a significantly diminished US military operation in Afghanistan, military budget cuts, the reduced need for imported crude oil from the region, the gas shale boom, and the potential for a longer-term agreement with Iran on its nuclear program, it is reasonable to expect a drawdown in US military presence in the Persian Gulf. This does not mean that US will not remain deeply engaged in the region. It simply suggests that the United States needs a new perspective on global oil and its role in the region. All this implies that the United States is likely to return to a greater over-the-horizon military posture in the Persian Gulf (Emerson & Winner, 2014). Having a productive and normalized diplomatic relationship with Iran — or even an alliance of sorts — will have positive consequences for the stability of the region. That is why making an accommodation with Iran makes perfect strategic sense.

Iran has increasingly become known as the proverbial “elephant in the room” of the international gas trade, a country that may possibly become a major game changer for the international gas markets in the near future. Yet its potential to move up in such global markets still remains today largely untapped due to several geopolitical and commercial reasons (Tagliapietra, 2014). For the United States to achieve its foreign policy goals in the Middle East more generally, but the Persian Gulf region more specifically, it needs to shift to what some experts have called “strategic reversal” (Friedman, 2011). That is to say, the United States must find a way to counterbalance Iran without maintaining its current deployment in Iraq and Afghanistan as well as without actually increasing the military power devoted to the region (Friedman, 2011, p. 111).

An extensive air campaign against Iran is a risky prospect. Nor can the United States count on the reemergence of Iraqi power as a counterweight to Iran. In the next decade, the most advisable option is to accommodate Iran, the way Presidents Roosevelt and Nixon encountered seemingly unthinkable strategic situations: “the creation of alliances with countries that had previously been regarded as strategic and moral threats” (Friedman, 2011, pp. 111–112). Roosevelt allied the United States with Stalinist Russia, and Nixon aligned with Maoist China, each to avoid an unacceptable alternative. Conditions on the ground put the United States in a somewhat similar position today vis-à-vis Iran. US-Iranian rapprochement would be awkward yet necessary, but also could prove to be temporary (Friedman, 2011, pp. 112–113).

On a positive note, others, such as Stephen Kinzer, have noted that Turkey and Iran have developed an understanding of modern democracy in that they have had long years of experience with democracy, as well as the desire and determination by their people to change the status quo. Both Iranians and Turks, Kinzer asserts, will make good soul mates for the United States, and that, if they are prepared to learn the lessons of history, US policymakers will find out that the road to peace in the Middle East runs through Ankara and Tehran, not Jerusalem (Kinzer, 2010, pp. 1–15). This is made somewhat problematic by recent anti-democratic moves by

the Erdogan regime and the continued suspicion of democratic motives and processes by the Mullahs in Tehran.

The rationale behind the rapprochement between the United States and Iran has prompted serious concerns among some observers about whether the United States should plan for the day after Iranians have completed a deal with the “P5 + 1” group. They affirmatively approve of such a strategy in order to contain Iran’s rising power in the region. This argument is predicated on the proposition that lifting sanctions will unleash Iranian power in the region that could counter US security interests there (Petraeus & Serchuk, 2014). What this and similar arguments disregard is the fact that if Washington is interested in regional stability, it can better achieve it through a close cooperation — not conflict with — Iran (Barzegar, 2014).

The impasse in negotiations between Iran and the West undoubtedly ended with the beginning of an interim deal on the Iran’s nuclear program reached in Geneva on November 24, 2013. This agreement has created a unique opportunity to integrate Iran into an international trading system. If the interim deal evolves into a comprehensive deal between Iran and the “P5 + 1” (China, France, Russia, Britain, United States, and Germany) group, it could unlock Iran’s potential to expand its natural gas sector (Tagliapietra, 2014).

From Tehran’s perspective, maintaining balanced relations with both Washington and Moscow will be in Iran’s long-term interests given the fluid and evolving politics of competition and cooperation between Moscow and Washington. This, however, requires a triangulation of political strategy in which Iran preserves an independent position, because aligning itself too closely with either Washington or Moscow runs the risk of alienating both by appearing too imprudent. The best course of action for Iran is to avoid entanglements in this traditional, cyclical, and renewed power game. Iran’s strategic loneliness and defensive posture requires that it maintains a dynamic equilibrium of sorts in its relations with both rival camps. Reaching a nuclear deal within the “P5 + 1” framework and the subsequent recognition of Iran as a “peaceful nuclear power” by the international community is not only consistent with Iran’s strategic interests but also the most pragmatic course of action under such circumstances. Iran’s strategic interests are ill-served by the persistence of the nuclear dispute and diplomatic deadlock with the West.

## **2.7. Conclusion**

Unless political, technical, and commercial barriers to Iran’s energy programs are effectively overcome, Tehran’s potential to expand the country’s natural gas exports will be largely blocked. Experts believe that without removing sanctions, it is unlikely that Iran will be an LNG exporter in the foreseeable future. Even if the political environment improves and sanctions are removed, NIOC would still need an

experienced international partner to deal with commercial and technical issues (Adibi & Fesharaki, 2011, p. 299). Two contrasting views can be invoked in this regard. The optimistic view holds that a successful outcome of the “P5+1” negotiations with Iran would most likely lead to a normalization of the relations between Tehran and Washington, with sanctions substantially lifted by 2015. This agreement will pave the way for some degree of normalization, despite domestic pressures in both Iran and the United States. The pressures by those in the US Congress and Israel who oppose President Barack Obama’s diplomatic efforts are likely to pose a major risk to achieving a long lasting agreement.

Likewise, in Tehran, domestic factions who consider Iran’s nuclear program a symbol of the country’s national identity and pride could make it difficult for Iranian negotiators to make necessary concessions and advance a sustainable basis for a negotiated solution. The proponents of this view argue that a long-term nuclear agreement will have a palliative and curative effect on the entire region. Advocates of such a view, such as the Iraqi Ambassador to the United States Lukman Faily, argue that a broader détente between the United States and Iran “will automatically lead to a better environment for mutual understanding ... on matters having to do with the Gulf, with nuclear proliferation, with the sectarian element and stability and security of Israel and Hezbollah and Syria are a direct extension of that” (Slavin, 2014).

A dissenting opinion, by contrast, would contend that the United States is first and foremost bent on establishing a “balance of power” rather than a “balance of interests” in the region. Seen from this perspective, the US position toward Iran will be recalibrated based not on long-term mutual and strategic interests of both parties concerned but rather on tactical and short-term adjustments. Ultimately, the proponents of this view insist, the United States intends to control Iran’s emerging power and influence in the region rather than normalizing its relations with Iran. Sanctions have been and will be eased far slower than what the Iranian negotiators believe will be the case and other challenging issues, such the problems associated with the Middle East peace process, Iran’s human rights and long-range missile program, the Israelis’ and the Saudis’ disagreement with Washington’s rapprochement with Iran would pose serious obstacles to a complete removal of sanctions. Under such conditions, Iran will never see a true development and expansion of its oil and gas industry that could bring it wealth and relief from punishing Western-imposed sanctions.

Furthermore, and irrespective of whether a general agreement is achieved within the “5+1” framework, Iran’s internal problems of poor infrastructure, insufficient technological capacity, the lack of a conducive environment to foreign investment, and mismanagement of the economy will delay its ambitious program of expanding its natural gas exports. Iran has yet to extract LNG from its offshore reserves in large part because of its technological incompetency while Qatar has become the world’s largest exporter of liquefied natural gas in the past 3 years using the same natural gas fields. A combination of internal and external political, economic, and

institutional barriers constrains the potential expansion of Iran's natural gas exports. Most particularly, Iran's LNG projects remain years away.

What adds to this pessimistic view is the reaction of US Congress to the Iran-Russia \$2 billion "oil-for-goods" deal, in which a barter arrangement that would see Iranian oil being exchanged for industrial goods including metals and food. Senators Robert Menendez, chairman of the Senate Foreign Relations Committee, and Mark Kirk wrote to President Obama and said that if Iran signed this agreement, "Washington should respond by reinstating sanctions eased under a preliminary nuclear agreement, rigorously enforce reductions in global purchases of Iranian crude and punish any violations to the fullest extent of the law" (Reuters, 2014).

A longer-term agreement between Iran and the West over Tehran's nuclear program will most likely unlock Iran's potential to expand its natural gas exports. Energy-hungry Asia, Turkey, and Europe have shown deep interest in such an eventuality. Although Iran's domestic consumption has in the past constrained its capacity to export natural gas, the Rouhani administration seems intent on reversing this trend by implementing new energy reform programs. There can be no doubt that Iran faces stiff competition — largely from Russia, Qatar, and Turkmenistan — en route to formulating as well as enforcing a new energy policy, but its vast natural gas reserves and its potential to expand its exports is a new reality with which the region must come to grips.

The prospects for normalization of the relations between the United States and Iran also pose new challenges to China that has close economic ties with Iran. Under a new agreement, the two sides have agreed to increase the amount of non-oil trade to 20 billion dollars a year. In 2013, the volume of trade ties between the two countries, including oil transactions, reached \$40 billion (PressTV, n.d.-b). Even the smaller country of Taiwan views lifting sanctions on Iran detrimental to its economic interests, for they would face competition from Japan, Europe, and the United States. The EU, by contrast, appears to be a major beneficiary of improved relations between Iran and the United States.

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## Chapter 3

# Non-Oil Exports from Iran

Massood V. Samii

### Abstract

Iran's non-oil export has shown noticeable growth in recent years. The gap between the oil export and non-oil export revenue has closed considerably, partly as a result of decline in the oil revenue, but mainly due to the rise in non-oil export. There are certain interesting developments in Iran's foreign trade. One is the direction of Iran's trade and its trading partners that has shifted from the West to the East. Another is the composition of Iran's non-oil export from primary and agricultural products to more processed goods particularly petrochemical and other industrial products. This chapter explores Iran's trade policies and strategies. It also focuses on the obstacles and challenges that the country still faces for further expansion of its export.

**Keywords:** Iran; export; trade; Iran foreign trade

### 3.1. Introduction

Iran historically has been concerned about dependency on its oil exports as the source of government income and foreign exchange earnings. Even before the 1978 revolution, there was concern that excessive dependency on one source of income was putting the country at major political and economic risk. Iranian oil revenue at that time constituted 98% of the country's foreign exchange earnings and about

half of government revenue. Fluctuation in oil prices, embargoes, and the emergence of alternative sources of energy were among potential risks that could impact the economy. The issue was how to diversify the economy and increase other types of export besides crude oil.

The main non-oil exports at the time were pistachio nuts and carpets. Each had a specific advantage in the global marketplace. Iran was one of the few countries producing pistachio nuts, and therefore it had a near monopolistic position in the global market. Persian carpets, with their outstanding reputation, were viewed as luxury products with very high value. They had a name recognition that differentiated them from other handwoven carpets in quality and design. However, limited numbers of non-oil exports were not enough to reduce dependency on crude oil revenue. Therefore, a major policy discussion even before the 1978 revolution was how to encourage production and export of non-oil products and diversify the sources of income for the country.

In order to stimulate exports, a trade promotion center was set up to develop policies and to assist potential Iranian exporters. The organization has survived years of political and economic turbulence in Iran and is still functioning as an institution dedicated to international trade as an advocate for exports. The Iran Trade Promotion Center (TPO) recognized that for economic growth and development to occur, it was imperative for the country to have successful trade activities. TPO maintains that "The successful experience of the world's leading countries in the economic sphere is the result of their strong focus on export promotion and the development of foreign trade. TPO's functions including promotion, facilitation, information, and administration, provide support for the business community. The three core functions of trade policy, trade promotion, and trade facilitation will provide support to build productive capacities, upgrade industrial and agro-technologies, and expand exports and markets."<sup>1</sup> Despite the recognition of the importance of expanding non-oil exports, Iran's exports have faced a number of structural and political problems that will be discussed subsequently.

Notwithstanding structural obstacles, the non-oil exports expanded in recent years and have become a major contributor to the foreign exchange earnings and more generally to the economic growth of the country.

The Iranian revolution in 1978 created structural changes in Iran, including in its economic sector. A long and costly war with Iraq and international sanctions shifted the attention of policy makers away from long-term strategic planning for the country. Iran became a war economy and was focused on short-term issues and preoccupied with survival. The policy of export promotion and economic diversification became less urgent and received a low priority until recently. However, in recent years, economic sanctions necessitated policy measures that once again

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<sup>1</sup>Trade Promotion Organization of Iran website: <http://en.tpo.ir/documents/document/11974/12273/Introduction.aspx>

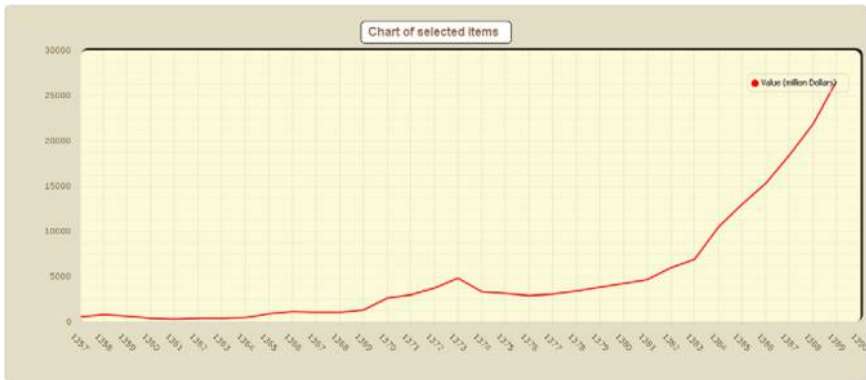


Figure 3.1: Iran non-oil export 1978–2011.

Source: Central Bank of Iran.

Note: The year 1357 in the Iranian calendar corresponds to 1978/1979 and 1390 to 2011/2012.

focused on reducing the reliance on oil revenues. Change in policy toward increased international economic activity including exporting and export promotion after the end of war began to show results in non-oil exports. For example, in 2013 while the oil export earnings declined by more than 42%, non-oil exports grew by 12.2% to U.S. 30 billion.

After the election of president Rouhani in 2013, Iran has once again prioritized economic development in general and non-oil exports in particular. The result has been a further sharp increase in non-oil exports, both in terms of quantity and value. Figure 3.1 demonstrates non-oil export earnings of Iran from the 1978 revolution to 2012.<sup>2</sup> The non-oil exports have further increased in 2013 (Bank Markazi Iran (Central Bank of Islamic Republic of Iran), 2013/2014). Reportedly “Iran’s first vice president says the country’s non-oil exports reached USD 16 billion in the first four months of the current Iranian calendar year (started March 21)”<sup>3</sup> which implies a \$48 billion for 2013/2014 if the current trend continues. This increase is at a time when oil revenue earnings in Iran declined due to an increase in domestic demand and lower international demand for its oil. Iran’s oil revenues declined from \$114 billion in 2011 to around \$62 billion in 2013. If this pattern continues, the non-oil exports will become as important as crude oil sales in the near future. A phenomenon that is unique for an OPEC member country and unimaginable only a decade earlier.

<sup>2</sup>The Iranian calendar, like the Islamic lunar calendar, takes as its starting point the Hegira, or the migration of the Prophet from Mecca to Medina. However, being a solar calendar, the year has 365 days and the first day of the year always begins at the spring equinox. Thus, the year 1390 began in March 2011 and ended in March 2012.

<sup>3</sup>August 24, 2014.

### 3.2. Iran's Trading Partners

There has been a major shift in Iran non-oil export partners. Before the revolution, Iran used to conduct a great deal of business with the United States and the European Union, but its exports have shifted to neighboring countries and to East Asia in more recent years. A major reason for this shift has been the economic sanctions by the United States and European Union, forcing the country to look to new markets for its commercial activities, including its non-oil exports. While the some sanctions were imposed by the United Nations, enforcement varied from country to country, with the United States and European Union enforcement being the most forceful. Export to the United States declined and eventually ceased altogether in recent years. Exports to the European Union also suffered considerably. The decline in exports to these two regions was compensated by a sharp rise in exports to the United Arab Emirates, Afghanistan, Iraq, and China. [Figure 3.1](#) reflects the impact of sanctions on the regional trade of Iran from 2005 when additional sanctions were imposed.

Some of the advantages that Iran has in its trade with Iraq, Afghanistan, and UAE are due to physical and psychic distance. Low physical distance is an important element of trade since it reduces the cost of transportation. The proximity of Iran to these countries reduces this cost. Moreover, social and cultural similarities make it less difficult to develop commercial relationships since the perceived risk may be less than for countries with large sociocultural differences. Consider linguistic affinities. In many countries in the region, people speak Farsi (or at least can understand it), and many Iranians speak Arabic. Arabic is being taught at schools in Iran. Another important similarity is religion. Iran and its neighbors are all Muslim. Iranians and a majority of Iraqis belong to the Shia sect, while most Afghans and some others are of the Sunni branch of Islam. Since the roots are common, there is great understanding of religious fundamentals which is helpful in creating mutual trust. Therefore, it becomes less difficult to communicate, build networks, and to conduct business transactions.

Finally, it is the improvement of political relations between Iran and its neighboring countries that has facilitated Iran's non-oil exports. Previously, Iran had hostile relations with its neighbors, particularly Iraq and Afghanistan. The Taliban in Afghanistan and Saddam Hussein in Iraq were extremely hostile to Iran. Their removal from power by coalition forces, and their replacement with leaders who had close ties with Iran resulted in a drastic improvement of political and economic relations with Iran ([Figure 3.2](#)).

A major share of the increase in exports from Iran to neighboring countries was made of products needed for infrastructure rebuilding and development. Products such as cement became an important export from Iran to these countries. Another export to neighboring countries has been electricity. Press TV reported that Iran has exported over 1000 MW of electricity to Afghanistan, Iraq, Pakistan, and Turkey. Iranian authorities claimed that there is a plan to

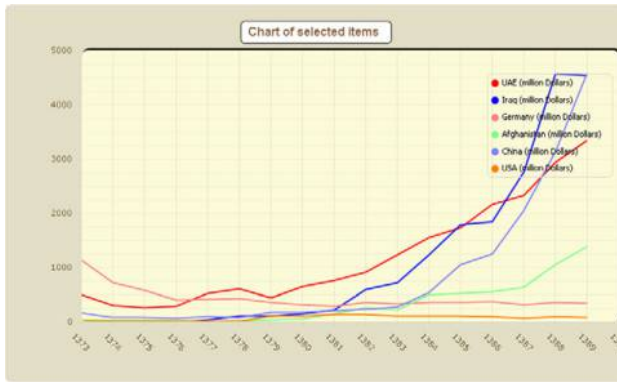


Figure 3.2: Iran non-oil export to selected countries.

*Note:* The year 1357 in the Iranian calendar corresponds to 1978/1979 and 1390 to 2011/2012.

increase the export of electricity considerably in the future to neighboring countries.<sup>4</sup>

Iran's economic relations with China have also grown in recent years. China's rising need for oil made it imperative to build strong economic ties with Iran, while mindful of the economic sanctions. As economic relations expanded, China also increased its import of non-oil products from Iran. Iranian Students' News Agency reported that "Iran-China non-oil trade hit 13 billion dollars in the first 10 months of the Iranian calendar year starting on March 21 (2013). Based on a report released by Iran's Customs, Iran's imports from China totaled 7.3 billion dollars and its exports reached 5.9 billion dollars. Iran's exports to China rose by 34.47 percent."<sup>5</sup> The report also mentioned that Iran exports to China include iron ore, methanol, propane, polyethylene, styrene, butane, ethylene glycol, par-xylene, chrome stone, marble, oil and mineral seals, and purified copper.

Iran has managed to bypass some of the economic sanctions by exporting other products besides oil and by shifting to the east in its trade, but one must recognize that the impact of the sanctions has impeded Iran's efforts toward building a vibrant and wide based international trade system.

### 3.3. Structure of Iran's Non-Oil Export

Historically Iran's non-oil exports were traditional products such as carpets and pistachio nuts. However, recently Iran has diversified its export structure to include other products such as petrochemical, construction material, and services. While the

<sup>4</sup>Press T.V. (September 26, 2014).

<sup>5</sup>Amiri Aghdaie and Zare Zardeini (2012), [www.ccsenet.org/ijbm](http://www.ccsenet.org/ijbm)

Table 3.1: Structure of Iran's exports.

	2011/2012	2012/2013	Share (%)
Agricultural and traditional goods	5181	5560	17.1
Pistachio nuts	2204	2482	7.6
Handwoven carpets	559	427	1.3
Others	2418	2651	
Metallic ores	1035	1169	3.6
Industrial products	27,590	25,137	77.3
Gas and oil products	8485	5149	15.8
Iron and steel	1522	1804	5.5
Organic chemicals	3770	3432	10.5
Plastic materials	3380	3643	11.2
Others	10,433	11,109	34.1
Others	13	689	2.1
Total	33,819	32,567	100

*Source:* Bank Markazi Iran (Central Bank of Iran) (2013).

traditional export sector remained important, exports of new products have been steadily and considerably growing in recent years. Traditional export shares have remained below 10% of total non-oil export but the industrial products have increased their share in total export to more than 77% (Table 3.1).

Persian carpet exports have hovered around half a million dollars and have even shown a slight decline over time. There are a number of factors both external and internal that contributed to this situation. External competition has become an important factor. Some low-wage Asian countries have become competitors in Persian carpet by developing a low-cost strategy while copying the pattern and design of the Persian carpets. Economic sanctions on Iran and the general economic recession in the United States and Europe are other major reasons for the lackluster performance of this sector. Internally, overvalued exchange rate, high inflation, high wages, government regulations, lack of international marketing ability, and small production units were major contributing factors.<sup>6</sup>

Pistachio nuts are the other traditional export of Iran. The exports of around \$2.5 billion contribute to about 7.5% of country's non-oil export. External demand for Iranian pistachio nuts remains strong and in 2012/2013 has resulted in a growth rate of 4.6% over previous year. However, since domestic prices were increasing and there was popular dissatisfaction with the price increase, the government

<sup>6</sup>Amiri Aghdaie and Zare Zardeini (2012), [www.ccsenet.org/ijbm](http://www.ccsenet.org/ijbm)

ordered a moratorium on the export of pistachio nuts in 2013. This helped alleviate domestic pressure on the price of the pistachio at the expense of its export.

The most important non-oil exports of Iran besides crude oil are industrial products. Iran has recognized that its comparative advantage was in petroleum-related products, natural gas, and petrochemical products. These industries use petroleum-related products as feedstock which Iran has in abundance. The industrial sector constitutes three fourth of Iran's non-oil export.

The increase in the exportation of petrochemical and chemical products was not incidental. Government focused on building these industries by investing heavily in their development. Natural gas, which is the main input for petrochemical production, is available in abundance in Iran. Both natural gas exports and petrochemical product exports became a strategic target of industrial planning for Iran. Numerous petrochemical plants were built in Iran. To promote production and the export of petrochemical products, the government established the National Petrochemical Company (NPC) as early as 1964 under the petroleum ministry. NPC's mission is to develop production and export of petrochemical-related products. Petrochemical factories are located in Shiraz, Ahwaz, Kharg Island, and many other locations. Products they produce include fertilizer, polymer, chemical, and aromatic among others for both domestic consumption and export (Table 3.2).

### 3.3.1. Performance of the Petrochemical Industry

In 2012/2013 export of petrochemical was over \$12 billion. Although data shows a slight decline compared to previous years, it is still a 54% increase in value term relative to four years earlier.

Although the government was the initial driving force behind the petrochemical development, the private sector has become increasingly involved in this industry. The Petrochemical Commercial Company, PCC, is one example. Established in 1990, it has become one of the largest companies in the Middle East. It was privatized in 2010 through selling a majority of its shares to the Iran Investment Corporation. Currently, according to the website of the company, it exports

Table 3.2: Petrochemical production and export.

	2008/ 2009	2009/ 2010	2010/ 2011	2011/ 2012	2012/ 2013
Production (thousand tons)	30,040	34,433	40,175	42,736	41,067
Export (thousand tons)	12,254	14,039	17,861	19,282	15,754
Export (million dollars)	7843	9147	11,559	15,177	12,061



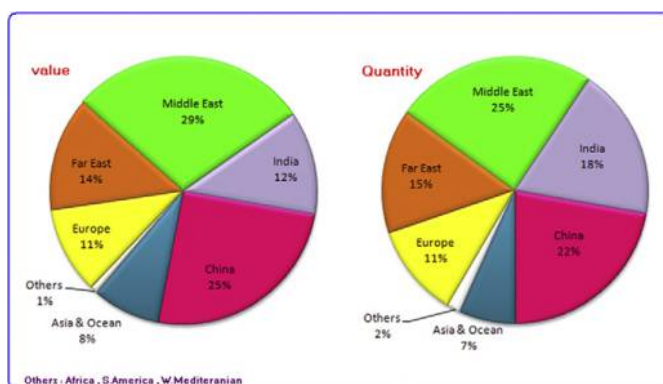


Figure 3.3: PCC export based on destination in 2010.

Source: Petrochemical Commercial Company.

internationally and has offices in eight different countries in Europe and Asia.<sup>7</sup> (Figure 3.3).

Iran has the second largest natural gas reserves in the world, which puts it in a very strong competitive position for expansion of its petrochemical industry in the future. The South Pars natural gas field (and north dome) that it shares with Qatar is the world largest reserve with a reported 1800 trillion cubic feet of gas and 50 billion barrels of oil. Export of natural gas is quite expensive since it either has to be liquefied before transported or transported through a pipeline. Iran exports considerable amounts of gas to its neighboring countries through various pipelines. Iran also uses natural gas for petrochemical production. Additionally, to support production and export of petrochemical products, the government provides indirect subsidies so the companies in this sector pay only 65% of the export price of natural gas to the government. This indirect subsidy has helped petrochemical firms to become highly price and cost-competitive in the international market. In general, Iran has successfully diversified its exports away from oil. However, there is still considerable room for further diversification of its exports.

Another sector that has had success in production and export is the steel industry. Iran produced 14.5 million tons of steel in 2012. Its steel production was greater than many countries in the world including a large number of developed economies. To put it in perspective, according to World Steel Report, Canada's production was 13.5 million tons and France was slightly higher with 15.6 million tons.<sup>8</sup> Since there is no sanction on the export of steel, Iran has successfully targeted its steel export as

<sup>7</sup>[www.petrochem-ir.net/](http://www.petrochem-ir.net/)

<sup>8</sup>[www.worldsteel.org](http://www.worldsteel.org)

a priority. In 2013, it exported close to \$2 billion of steel which is expected to continue to increase in the future.

### ***3.3.2. Iran's Military Equipment Exports***

Iran, before the revolution, was a major importer of military equipment from Western countries, particularly the United States. After the 1978 revolution, the relationship between Iran and the United States took a turn for the worse and the two countries broke off their political and economic relationship. The United States imposed sanctions on Iran and trade and investment flows between the two countries ceased. Other Western countries also followed the U.S. policy and gradually imposed sanctions. One of the major causalities of these developments was the arms exports to Iran from the United States and European countries.

The war with Iraq that began with the invasion of Iran in September 1980 and lasted until August 1988 was one of the longest wars in history. In order to sustain its war effort, Iran was in dire need of military equipment and supplies. Although it managed to purchase military equipment on the black market at premium price, policy makers decided that they needed to establish a military industry that would develop and build domestic supplies for its military. Over time, the Iran military industry has become a robust element of the economy with large employment and extensive research and development. It produces a diverse array of military equipment including tanks, armored vehicles, guns, aircrafts, helicopters, ships, submarines, electronic equipment, radar, and satellites. One of its more recent achievements has been the construction of drones.

There are anecdotal and unconfirmed reports that Iran exported military equipment to various countries but there is no confirmed report of the amount and the type. Most exportation is foreign policy driven and not based on commercial or financial considerations.<sup>9</sup> However, if the country were to focus on commercialization and sale in the global market, it could become a major source of export earnings for Iran. Clearly there are considerable obstacles to the commercialization of these products and sale in the global marketplace. The most important obstacle is the current sanction regime. The United Nations has forbidden any trade of military goods with Iran, either imports or exports. Not only are sanctions a major obstacle to military equipment exports, but also stiff competition from more established suppliers of military equipment constitutes another hurdle that the country must overcome.

The potential for spinning some of these products for civilian use in the commercial market is huge. In the West, a number of advanced technological products were

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<sup>9</sup>For example it was reported by Aljazeera news that the Iranian secretary of Iranian National Council Ali Shamkhani has met with Lebanese officials, including Prime Minister Tamman Salam to supply military equipment (Aljazeera, September 30, 2014).

the result of military or government-funded research and development that eventually found their way to civilian use. Iran can have the same approach and explore global market for possible commercial use of these products.

Drone production provides an example of such positive spillovers. Drones or Un-manned Aerial Vehicles (UAV) were developed initially for military surveillance and information collection. Currently, they are being considered for commercial usage in areas such as aerial photography (used for real estate marketing) and delivery of mail. The price of drones has declined drastically and availability has increased. One can buy a drone online for the price of about \$500. This industry is in its infancy stage. Iran is very active in the research, development, and production of drones for military intelligence. Commercialization of the product for the civilian market and particularly for the global market is great opportunity that Iran can exploit.

Another example is helicopter production. Iran has developed a number of different types of helicopters for military use. Privatization of this industry and reorienting it toward international sales could lead to major export earnings. These are only a few examples of potential non-oil exports in the future. The decision to move in this direction is a policy choice for the country that would require privatization of military technology and expansion of the private sector in Iran.

### ***3.3.3. Barriers to the Expansion of Non-Oil Exports***

Iran has expanded its non-oil exports significantly in the last decade, however, it still faces a number of obstacles in attempting to increase them further to a level that would make it independent of oil revenue. Some of these obstacles are external and some internal.

The most significant problem currently, as was noted earlier, is the economic sanctions regime. Economic sanctions limit the country's ability to compete in an international market and to exploit its export capabilities to the fullest extent. For many products Iran is kept out of global markets. Despite economic sanctions, it has managed to increase its export earnings, but removal of sanctions would open many opportunities and markets for its exported goods. Europe and the United States collectively have a population of around 600 million people with high purchasing power that could potentially become buyers of exports should sanctions be removed.

Non-oil exports also suffer from the overvalued exchange rate in Iran. While the Rial has been devalued against major currencies drastically at times, very high and persistent inflation in Iran has quickly eliminated any gain in its export competitiveness as a result of exchange rate devaluation. For example, after a number of years of hyperinflation the Rial was devalued by 200% in 2011–2012. But the very high inflation post devaluation in 2013 and 2014 once again made the currency

overvalued. Iran's multitier currency system is fairly complex. Oil revenue permits the government to support overvalued exchange rates through oil export earnings and to maintain an artificially strong currency. Such policy has some benefits in alleviating pressure on inflation particularly since Iran is highly dependent on imports, but it adversely affects exports.<sup>10</sup>

Another problem is government regulations and bureaucracy, in general, and for exports in particular. A detailed study of the non-oil export potential for Iran by the United Nations Industrial and Development Agency, UNIDO, identified numerous issues in this regard. The report concluded that excessive government involvement and micro-management by multiple agencies were the main barriers stymieing the expansion of this sector. At the top of UNIDO's recommendation was, "A reduction of the prevailing export formalities to those that are strictly necessary, with the remaining rules being consolidated under a single agency."<sup>11</sup> The document further recommended, "The setting of appropriate regulations, guidelines and procedures by the government, with officials restricting themselves to their supervisory roles without seeking to micro-manage the day-to-day operations of exporters."<sup>12</sup> That would make it easier for Iranian exporters to engage in their activities without being overburdened by bureaucratic oversight and management.

The limited scope and development of the Iranian private sector are also impediments for export expansion. This is particularly noticeable in the industrial and agricultural sector. The ability to develop a vigorous and broad based domestic production sector is critical for exports. International trade and export theory maintains that most products are first developed for the domestic market before they are exported to the global marketplace. Building a strong and vigorous private sector, it is acknowledged, is key for competing successfully in the global market. Iran's industrial sector, mainly producing consumer products, faces major competition from imports, especially from China. One reason is the overvalued exchange rate fueled by oil revenue. Another reason is the weak corporate governance in Iran.

Proper corporate governance is a major element for the development of a vibrant economy. The Organization of Economic Cooperation and Development (OECD) has proposed a framework for the establishment of appropriate corporate governance. It claims that "the basis for the review will be the 2004 version of the Principles, which embrace the shared understanding that a high level of transparency, accountability, board oversight, and respect for the rights of shareholders and role of key stakeholders is part of the foundation of a well-functioning corporate governance system."<sup>13</sup> To build a strong private sector that is focused on

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<sup>10</sup>This is a short-term benefit since in the long run it makes domestic production noncompetitive with import and leads to disadvantage for domestic producers.

<sup>11</sup>UNIDO (1998).

<sup>12</sup>*Ibid.*

<sup>13</sup>OECD (2004).

international trade, these principles should be strengthened. Transparency and accountability are particularly important for international trade and investment since foreign partners are not familiar with the institutional structure of the country.

Finally, lack of export knowledge by the private sector is a major hurdle for the expansion of exports. The number of enterprises engaged in exports is far fewer than those engaged in imports. As a result, the exporters' exposure to foreign markets is largely limited to the export of carpets and dried fruits including pistachio nuts<sup>14</sup> or products that have been targeted by government for export or are receiving subsidies such as petrochemicals. Exporting in the current global environment requires understanding of the institutional environment and competitiveness of target countries. Competing with established producers and exporters in those markets is not an easy task. While the export promotion center of Iran aims at development of such knowledge and expertise, it would take considerable time to build the learning curve through practical experiences as the actual exporter.

### **3.4. The Promise of a Sanction-Free Future and Conclusion**

Iran has managed to reduce its reliance on foreign exchange earnings from crude oil to non-oil exports. This shift has been partly due to the sanctions by the United States and European Union but also because of extensive planning over the years to promote petrochemical and other non-oil exports. The future could be bright and witness further increase in non-oil exports as new production facilities of petrochemical and other manufactured goods come online and their output grows. However, numerous obstacles lie in the way of such expansion.

There has been a shift in the trade of Iran away from the West and toward the East. Iran's non-oil exports to the United States and Western Europe have steadily declined and for some products have come to a complete stop. However, Iran has managed to find new partners in Asia particularly in China. Iran's trade in general and exports of both oil and non-oil to China have increased considerably in the recent years.

Regional political changes particularly in central Asia and neighboring countries of Iraq and Afghanistan have created a major opportunity for an increase in trade for Iran. Non-oil exports to these countries have increased considerably in the last few years and barring any unforeseen major political change in those countries or in Iran's relations with those countries the trend should continue in the future. One reason being the major infrastructure development needs of neighboring countries requiring products that are expensive to transport from far away, giving Iran a locational advantage.

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<sup>14</sup>Op cit.

Iran's investment in the development of research and technology, particularly for military use, provides future opportunities for the expansion of exports. Already Iran is exporting military products to specific countries mostly in form of foreign aid. This could eventually present a lucrative export potential. More importantly, many of products developed by Iran's military industrial complex can also have nonmilitary uses. Once they are commercialized they could become a major source of foreign exchange earnings by Iran. For many of these products there is a huge international demand particularly if Iran attempts to compete on prices in foreign markets.

Iran does face serious obstacles to the expansion of its non-oil export earnings. International sanctions constitute the most important one of these obstacles.<sup>15</sup> Removal of sanctions would open major opportunity and markets for export. It would also eliminate many of the problems that Iran faces in financial transactions including payments for its international activities. There are a number of areas that are likely to benefit. It can be expected that traditional exports would sharply increase, but also, the doors will open for exploring and expanding new activities. For example, tourism in Iran is very much underdeveloped even though the country's rich heritage in architecture and historical monuments, as well as a varied natural environment should propel it among the major destinations for visitors seeking unique cultural experiences and among history buffs. Much needed investment in building world-class facilities as well as developing professionalism and know-how could flow into the country following the economic reintegration of Iran into the world economy. Specialized subcategories of tourism, such as medical tourism could be developed. Indeed, many members of the medical profession in Iran are highly qualified and capable of providing advanced care. Presently, hospitals, like so many other facilities, are hobbled by the many obstacles resulting from sanctions, in particular for obtaining the advanced equipment that they need. The lifting of sanctions will make technology transfers to take place, not just in the medical field but in all professional, educational, and industrial areas that have been chafing under the weight of severe restrictions. Iranian businesspeople and consumers are well aware of the fact that Western technology is more advanced than that obtained from China, Russia, or India and greatly prefer the former. Many areas of the domestic economy are badly in need of investment and technological upgrades. As an example, due to sanctions, Iran's civilian airline industry has one of the oldest fleet in the world. Although, Iranian airlines have recently purchased a number of Russian made aircrafts to refurbish their fleet, passengers have a marked preference for aging Boeing or Airbus planes, leased or bought from foreign airlines or purchased before the revolution. The automotive sector or the telecommunications sectors are other candidates for investment. Most surprising for an oil producing country, Iran

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<sup>15</sup>At the time of writing of this chapter Iran still faces sanctions. But there are negotiations that are taking place which may result in removal of part or full sanctions.

must import gasoline, due to a lack of refining capacity. Foreign technology and investment in that area and the petrochemical industry in general, is badly needed.

In sum, the country has huge potential and great needs that can be fulfilled in a post-sanctions era. It is indeed on a solid domestic base that exports can develop. This is not to say that obstacles and challenges will cease to exist altogether. There are governance issues and institutional factors that must be addressed to strengthen Iran's economy and facilitate its exports. One such factor is the creation of an industry-wide private sector that is competitive in the global market. However, competing with multinational firms that have been engaged in international trade and export in the past would not be an easy task. It requires training, institutional support, and an effective export strategy. In addition, the reduction of red tape and excessive regulations, to be replaced by an export friendly environment and proper corporate governance would be important for nurturing a healthy and vibrant non-oil export sector.

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## Appendix

Table A1: Weight of exports (thousand tons).

	Percentage change										Share (%)			
	2008/ 2009		2009/ 2010		2010/ 2011		2011/ 2012		2012/ 2013		2011/ 2012		2012/ 2013	
Agricultural and traditional goods	2721	2693	3700	3094	3767	-16.4	21.7	4.7	5.4					
Fruit, fresh or dried	1029	1108	1285	1237	1464	-3.7	18.4	1.9	2.1					
Pistachio	106	119	151	139	129	-8.0	-7.3	0.2	0.2					
Grapes and raisins	84	121	153	136	153	-11.4	12.8	0.2	0.2					
Dates	105	94	119	134	139	12.8	3.2	0.2	0.2					
Apples	342	356	268	226	399	-15.6	76.4	0.3	0.6					
Handwoven carpets	8	8	8	7	6	-17.6	-11.7	-	-					
Live animals	58	29	2	15	6	-	-63.1	-	-					
Vegetables and plants	1121	1112	1139	1154	1543	1.3	33.6	1.7	2.2					
Saffron	0.1	0.1	0.1	0.1	0.1	13.3	13.9	0.0	0.0					
All kinds of hides and leather	27	24	25	25	28	0.2	12.0	-	-					
Casings	3	2	2	3	3	21.1	7.8	-	-					
Others	475	409	1238	653	717	-47.2	9.8	1.0	1.0					
Metallic mineral ores	6408	11292	18819	18355	21883	-2.5	19.2	27.6	31.3					
Industrial goods	24109	33515	37678	44978	44284	19.4	-1.5	67.7	63.3					
Gas and oil products	6365	7934	7463	10656	7125	42.8	-33.1	16.0	10.2					
Petroleum gas and other petroleum hydrocarbons	4326	4861	4610	7064	2976	53.2	-57.9	10.6	4.3					
Naphthalene and other aromatic hydrocarbons	99	163	76	99	67	30.5	-31.9	0.1	0.1					



Table A1: Continued.

		2008/ 2009	2009/ 2010	2010/ 2011	2011/ 2012	2012/ 2013	Percentage change			Share (%)		
							2011/ 2012	2012/ 2013	2013	2011/ 2012	2012/ 2013	2013
Light oils and products		877	1478	905	1383	1294	52.8	-6.4		2.1		1.9
Cast iron, iron, steel and their articles		864	1422	1232	1598	1902	29.7	19.1		2.4		2.7
Organic chemicals		5728	6059	6375	6331	5227	-0.7	-17.5		9.5		7.5
Cyclic hydrocarbons (benzene, xylene, toluene, etc.)		1100	1172	634	1240	864	95.7	-30.3		1.9		1.2
Methanol (methyl alcohol) and ethylene glycol		3106	3683	4440	4284	3514	-3.5	-18.0		6.4		5.0
Aluminum, copper, zinc and their articles		269	428	354	376	301	6.4	-20.1		0.6		0.4
Plastic materials and products		1072	2041	2258	2209	2415	-2.1	9.3		3.3		3.5
Soil and stone, cement, plaster, stone and ceramic products		5088	10277	12931	15566	19329	20.4	24.2		23.4		27.6
Ready-made clothes, tricot, and all kinds of fabric		31	34	29	33	40	12.5	20.5		-		0.1
Transportation vehicles and their spare parts		87	94	112	80	109	-28.6	36.0		0.1		0.2
Inorganic chemicals		2124	2195	2849	2658	1957	-6.7	-26.4		4.0		2.8
Metallic oxides and hydroxides		214	130	217	227	267	4.5	17.4		0.3		0.4
Ammonia		885	681	1130	1012	448	-10.5	-55.8		1.5		0.6
All kinds of sulfur		691	1104	1218	1126	917	-7.5	-18.6		1.7		1.3
Machine-made carpets and other kinds of carpeting		39	39	45	45	54	0.0	20.0		0.1		0.1

Ornaments and jewelry	0	0	0	0	0	40.5	-54.4	0.0	0.0
Soaps and other detergents	131	240	221	227	270	2.6	19.3	0.3	0.4
Footwear	19	19	17	18	20	2.0	10.3	-	-
Others	2293	2733	3792	5182	5537	36.6	6.8	7.8	7.9
Goods not elsewhere classified	14	1	0.4	1	2	183.8	94.1	-	-
Total	33,253	47,502	60,198	66,429	69,936	10.4	5.3	100.0	100.0

Source: Islamic Republic of Iran Customs Administration.

Table A2: Value of exports (million dollars).

		Percentage Change						Share (%)		
		2009/2010			2010/2011			2011/2012		
		2008/2009	2009/2010	2010/2011	2010/2011	2011/2012	2012/2013	2011/2012	2012/2013	2013/2014
Agricultural and traditional goods		3304	4133	5056	5181	5560	2.5	7.3	15.3	17.1
Fruit, fresh or dried		1307	1779	2194	2204	2482	0.4	12.6	6.5	7.6
Pistachio		727	932	1136	1089	1139	-4.2	4.6	3.2	3.5
Grapes and raisins		139	266	341	318	375	-6.8	18.1	0.9	1.2
Dates		90	92	148	189	182	27.5	-3.9	0.6	0.6
Apples		176	277	238	191	331	-19.7	73.0	0.6	1.0
Handwoven carpets		422	495	557	559	427	0.3	-23.6	1.7	1.3
Live animals		136	71	9	58	28	-	-51.9	0.2	0.1
Vegetables and plants		474	685	697	653	733	-6.4	12.3	1.9	2.3
Saffron		92	180	332	368	419	11.0	13.9	1.1	1.3
All kinds of hides and leather		159	155	152	190	227	25.1	19.4	0.6	0.7
Casings		120	64	52	97	111	87.4	14.4	0.3	0.3
Others		596	705	1063	1052	1133	-1.0	7.7	3.1	3.5
Metallic mineral ores		319	702	1298	1035	1169	-20.3	13.0	3.1	3.6
Industrial goods		14,662	17,017	20,194	27,590	25,137	36.6	-8.9	81.6	77.2
Gas and oil products		3819	3925	4892	8485	5149	73.5	-39.3	25.1	15.8
Petroleum gas and other petroleum hydrocarbons		2873	2586	3167	6135	2462	93.7	-59.9	18.1	7.6
Naphthalene and other aromatic hydrocarbons		17	24	38	47	27	23.3	-42.3	0.1	0.1
Light oils and products		614	821	668	1247	1253	86.6	0.5	3.7	3.8
Cast iron, iron, steel and their articles		679	1041	1015	1522	1804	49.9	18.5	4.5	5.5
Organic chemicals		3130	2436	2818	3770	3432	33.8	-9.0	11.1	10.5
Cyclic hydrocarbons (benzene, xylene, toluene, etc.)		972	885	617	1335	1042	116.3	-21.9	3.9	3.2

Methanol (methyl alcohol) and ethylene glycol	1041	828	1267	1736	1574	37.0	-9.4	5.1	4.8
Aluminum, copper, zinc and their articles	778	915	1146	1269	917	10.7	-27.7	3.8	2.8
Plastic materials and products	1411	2301	2860	3380	3643	18.2	7.8	10.0	11.2
Soil and stone, cement, plaster, stone and ceramic products	526	1286	1276	1426	1875	11.8	31.5	4.2	5.8
Ready-made clothes, tricots, and all kinds of fabric	177	260	157	165	180	5.3	8.9	0.5	0.6
Transportation vehicles and their spare parts	456	473	589	370	557	-37.1	50.4	1.1	1.7
Inorganic chemicals	751	349	650	804	561	23.5	-30.2	2.4	1.7
Metallic oxides and hydroxides	88	62	76	108	106	40.7	-1.1	0.3	0.3
Ammonia	402	180	400	455	230	13.7	-49.4	1.3	0.7
All kinds of sulfur	217	61	120	162	151	34.8	-6.9	0.5	0.5
Machine-made carpets and other kinds of carpeting	232	277	312	338	393	8.2	16.3	1.0	1.2
Ornaments and jewelry	68	146	263	708	623	169.3	-11.9	2.1	1.9
Soaps and other detergents	84	169	159	167	206	5.3	22.9	0.5	0.6
Footwear	92	125	123	150	130	21.8	-13.3	0.4	0.4
Others	2460	3316	3934	5036	5667	28.0	12.5	14.9	17.4
Goods not elsewhere classified	48	39	2	13	700	-	-	-	2.2
Total	18,334	21,891	26,551	33,819	32,567	27.4	-3.7	100.0	100.0

Source: Islamic Republic of Iran Customs Administration.



## Chapter 4

# The Automotive Industry in Iran: A Critical Analysis

Mike Wilman and Bob Bax

### Abstract

This chapter explores the opportunities and challenges for Western firms that wish to engage in manufacturing operations in Iran, and particularly in the automotive industry. Although Iran has a long and fruitful history of embracing foreign investment, collaboration with foreign firms suffered in the aftermath of the Islamic Revolution in 1979. The imposition of UN sanctions in 2012, following the disagreements between Iran and leading Western powers over Iran's nuclear policy, has resulted in a further exodus of foreign manufacturers from Iran, hurting the production quality, adoption of up-to-date technology and alignment to international standards for manufacturing, such as vehicle safety and engine emissions in Iran.

The removal of sanctions, contingent on the success of nuclear negotiations between Iran and leading world powers, could provide Iran with an opportunity to recommence manufacturing collaboration with Western firms. The case of the automotive industry discussed in this chapter indicates some of the challenges that Iran is likely to face if it once again wants to become a player in international markets.

**Keywords:** Foreign collaboration; joint venture; manufacturing standards; exports; design; technology challenges

## 4.1. Industry Profile

### 4.1.1. Regional Developments and Conflicts

Conflicts and rivalries throughout the Middle and Far East regions since the end of the Second World War explain, to some extent, the cause of the fragmented development of the auto industry throughout these regions, with development taking place at different times and at different levels of technology adoption and knowledge management. However, Iran, partly owing to the investment in Western-style industries during the Shah years, has a rich heritage in many aspects of manufacturing, including automobiles, and thus stands to reap the benefits of this history should current negotiations be successful.

The aftermath of the Second World War resulted in many geo-political shifts, ranging from the Cold War between the prior Western allies and the then USSR, partition of India in 1947, and the creation of West and East Pakistan (later to become Bangladesh in 1971), the creation of the State of Israel (ca. 1948), and the final takeover of China by the Communists under Mao Ze-dong in 1949, with Chiang Kai-shek of the Kuomintang regime being pushed out of mainland China to Formosa (now Taiwan). The Japanese actions in China during this war, and the subsequent American post-war involvement in the rehabilitation of Japan, added to China/Western tensions.

While the Cold War was simmering in Europe, the Korean War from 1950 to 1953 acted as a further divisive factor between East and West, particularly with mainland China. The American support of Formosa (Taiwan), also added to the tensions with the Chinese Communists. The Russian missile involvement in Cuba in 1961–1962 further complicated geo-political considerations between capitalism and communism.

The British and American involvement in the settlement of the State of Israel in 1947–1948 created a significant divide between the Arab League States. This resulted in many Western businesses that traded with Israel being excluded from trade with oil-rich states by the Arab League Boycott of Israel. The Partition of India also had ramifications for religious tensions, for Muslims with Christians and Jews.

A temporary agreement between Iran and the P5+1 countries (the United States, Russia, China, France, Britain and Germany) has allowed Iran to continue receiving approximately USD 700 million per month from its frozen accounts, albeit with restrictions in place in sectors such as banking and energy (Business Monitor International, 2014). This has been accompanied by the lifting of bans on exports to Iran of technology components such as parts for Boeing airplanes. The lifting of sanctions could lead to a boost in confidence and increased foreign direct investment into many areas of Iranian manufacturing, creating jobs and leading to increased business and consumer spending.

#### **4.1.2. Auto Industry Developments and Trends**

Iran has a strong history of volume vehicle production and this is supported by a significant domestic demand base. With a population of approximately 78 million, a competitive wage rate, low energy costs and low land values, there are strong indicators for Iran once again to become a significant producer of vehicles with the capacity to export to other markets in the Middle East and Europe. Indeed, these comparative advantages in international trade could make Iran an attractive destination for Western automakers who are looking to build new low-cost, modern, lean-manufacturing plants, following the pattern developed in countries such as Turkey.

Iran's largest export market is Iraq, which took almost 60% of Iranian passenger car production during the first six months of the Iranian year commencing 21 March 2014, according to reports from Iraqi Customs, the Iranian State News Agency (ISNA) and Business Monitor International. IKCO is planning to partner with an Iraqi production facility to assemble 30,000 vehicles per year. The Ivory Coast Transport Minister, Gaoussou Toure, has also indicated an interest in collaboration with Iran's automakers.

In June 2014, Ahmad Nematbakhsh, the secretary of the Association of Iranian Car Manufacturers, stated that 90% of cars produced in the country meet Euro-4 standards (Business Monitor International, 2015). He also added that Euro-4 standards integrated into car components cut fuel consumption and assist in environmental protection. Models such as the Peugeot 206, L-90, Samand and Tiba are some of the vehicles conforming to the Euro-4 standards. However, the challenge remains that Iran will need to make continuous improvements to its manufacturing quality and vehicle designs if it is to continue to produce vehicles to EU and US standards and export to key and growing international markets.

#### **4.1.3. Automotive Market Trends and Forecasts**

Table 4.1 shows that total vehicle production, after falling by almost two-thirds between 2012 and 2013, began to rise steadily and is forecast to reach between 1.7 and 1.8 million units by 2018 (Business Monitor International, 2015). Vehicle fleets will also increase in size to 2018 but the number of vehicles per 1000 of the population will fall from 156 to 145 during the same period. The forecast thus takes into account the potential for exporting and for increased fleet sales, but individual ownership continues to be affected by the sanctions and the dislocation to individual wealth.

Table 4.2 reveals that passenger car production fell by one-third between 2012 and 2013, but is forecast to rise to just under 1.7 million by 2018. Table 4.3 shows that commercial vehicle production will rise by just under 10% between 2012 and 2018, indicating a modest but steady rise in business-to-business growth and spending.



Table 4.1: Automobile market in Iran — Historical data and forecasts.

	2012	2013	2014f	2015f	2016f	2017f	2018f
Vehicle production (units)	993,856	643,320	1,078,492	1,277,377	1,572,430	1,729,354	1,886,749
Vehicles per 1000 of the population	156.0	135.7	137.2	138.0	139.5	142.3	145.8
Vehicle fleets (units)	11,920,000	10,507,557	10,766,031	10,970,846	11,227,117	11,583,442	12,009,252

Source: Business Monitor International (2015).

Table 4.2: Passenger car market.

	2012	2013	2014f	2015f	2016f	2017f	2018f
Passenger car production (units)	871,997	538,170	941,797	1,130,157	1,412,696	1,553,965	1,693,822
Passenger car sales (units)	1,030,995	711,000	1,102,050	1,278,378	1,470,134	1,602,446	1,762,691
Passenger cars per 1000 of the population	139.0	122.3	123.5	124.2	125.4	127.7	130.7

Source: Business Monitor International (2015).

Table 4.3: Commercial vehicle market.

	2012	2013	2014f	2015f	2016f	2017f	2018f
Commercial vehicle production (units)	143,162	113,041	145,576	156,534	169,301	185,334	203,761

Source: [Business Monitor International \(2015\)](#).

Table 4.4: Top 10 best-selling car manufacturers, 2014.

Manufacturer	Sales (units)	Share (%)
Saipa	138,577	35.1
Peugeot	121,176	30.7
Iran Khodro	54,887	13.9
Hyundai	20,265	5.1
Renault	19,629	5.0
Kia	8946	2.3
Chery	8162	2.1
Geely	5764	1.5
Lifan	4741	1.2
Toyota	4634	1.0

Source: [Focus2Move](#) and [Business Monitor International \(2015\)](#).

Table 4.4 shows the top 10 automakers active in Iran, either through assembly, manufacture or importing, and it is very interesting to note that Peugeot still retains 30% of the market despite the sanctions, second only to domestic automaker Saipa with 35% of the market. This shows that the withdrawal of Western companies from involvement in manufacturing after sanctions were imposed did not necessarily seriously damage their brand equity with Iranian customers, or their ability to continue participating in domestic markets, albeit via the development of alternative channels to market.

## 4.2. The Impact of Sanctions

Unfortunately, the imposition of sanctions in 2012 led to companies such as Peugeot-Citroen and Renault (between them controlling approximately one-third of country production until that time) having to pull out of their manufacturing

ventures and import vehicles instead. In 2014, for example, Renault announced an agreement with ISNA, Iran's largest state-owned carmaker, to import Renault Clio 4 and Captur cars. The sanctions also led to a dramatic fall of 94% in vehicle exports from Iran during the year March 2013–2014, a huge loss of revenue from foreign exchange earnings, as well as loss of future market opportunities.

Amidst such falling exports due to sanctions, some recent developments provide hope for the future. For example, according to a recent report of the Business Monitor International (Q1, 2015), PSA Peugeot-Citroen will seek a joint venture (JV) to manufacture 301 and other models with its previous partner Iran Khodro, while Renault is presently in talks with Saipa about buying an equity stake in its Pars Khodro subsidiary.

During the latter part of 2014 and the early part of 2015, important announcements by Government Ministers indicated a desire for Iran to upgrade its auto manufacturing capability. In December 2014, and again in January 2015, the Minister for Industry, Mines and Trade, Mohammad-Reza Nematzadeh, stated a desire for Iran to upgrade all of its auto factories from assembly to manufacturing plants for vehicles as well as parts. The Minister also indicated a desire for a reduction in state involvement and ownership of those auto manufacturers that currently receive state subsidies, and stated that Iran is willing to accept foreign investment in its textiles, auto and nanotechnology industries. Interestingly, the Minister also called for domestic automakers to upgrade vehicle quality and encouraged the development of new technologies such as electric vehicles. If successful, Iranian automakers would then be able to compete in export markets.

A significant and far-reaching aspect of his announcement is that any future joint venture between domestic Iranian automakers and foreign manufacturers would require the domestic companies to produce 40% of output, rising to 85% over five years. It is also important to provide opportunities for job creation, with its associated education and training opportunities, for young people. This is an important objective because there is a high rate of youth unemployment in the country (ISNA).

President Hassan Rouhani has also called for Iran's auto industry to improve its regional and international status so as to be more competitive in the global marketplace. He also stressed the importance of the industry upgrading vehicle quality and seeking closer collaboration with academic and research centres ([www.theiranproject.com](http://www.theiranproject.com), 2015).

These comments highlight concerns with the quality of the domestically manufactured cars, the plethora of obsolescent models and designs, and non-compliance with Western regulations concerning construction integrity, safety and engine emissions. These factors together add up to a significant requirement for the need for Iran's auto industry to be upgraded to international standards.

These factors also highlight the considerable risks if the diplomacy does not produce an agreement or if the process stalls for a significant amount of time.

The auto industry is already falling behind the standards of Western manufacturers, and hence increasing exclusion from international auto markets, will have exponential effects on the country's ability to stay ahead technologically. The president of Iran's automaker (IKCO), Hashem Yekehzare, stated that the company's vehicles will meet as a minimum the Euro VI and similar global standards by 2026. To achieve this, a technology partnership with global automakers will almost certainly be required.

Although the current Iranian automobile industry size is rated as 18th in the world, it is one of the largest in the Middle East region. With annual production at about 1.2 million units in 2014, and expected to rise to over 1.7 million in 2018, Iran compares favourably with market growth rates seen in China, Taiwan, Romania and India. There are some 13 public and private automakers in Iran, with Iran Khodro and Saipa counting for about 94% of domestic production ([ISNA and Business Monitor International, Q1 2015](#)).

Despite the anti-Western views in Iran, and the American-led sanctions programme, the French, through the PSA Group of Peugeot and Citroen, and Germany through Volkswagen, have secured JVs that have enabled the Iranian Automotive Industry to flourish based on the transfer of older model designs to be adapted to meet local manufacturing and styling requisites. Similarly the Japanese and Koreans have assisted with the more basic pick-ups and commercial vehicle requirements from Mazda, Isuzu, Dacia and also with Daewoo until it was progressively absorbed into the US giant General Motors from 2001 to 2011.

In March 2014, the chairman of the Competition Council of Iran, Reza Shiva, reported that Iranian car buyers are unhappy because of rising vehicle prices, and automakers are unhappy because of falling profitability. Imports have been rising steadily and just two companies are responsible for 70% of imports. During the period from March 2014 to January 2015, car imports into Iran were worth \$1.625 billion, a 50% rise over the same period of the previous year.

The development of the Iranian auto industry has followed a pattern similar to Chinese model of automotive development. The initial requirements for the more utilitarian automotive products like, pick-ups and commercial vehicles came from small JVs with Japanese and Korean manufacturers. The transition to cars started with a JV with Volkswagen that took the Santana, which failed as a viable model in Europe, to become China's ubiquitous maroon coloured Taxi. This change in the openness and visibility in China was brought about by Deng Xiaoping, with the provision of a communist view of capitalism. This even allowed a JV with General Motors in the production of a Buick product.

It is clear that the infrastructure in Iran has the scale to produce almost 2 million vehicles a year, in terms of the key requirements of producing good quality body stampings used in modern monocoque vehicle structures, driveline components such as engines, gearboxes and axles. The local availability of automotive components such as brake, suspension systems and glass products is clearly substantial.

The opportunity for other Western automotive manufacturers to get involved in the Iranian Market is predicated on the United States and its supporters at the UN, finding a way to solve with the Iranians the tensions surrounding Iran's true nuclear ambitions, and its relationship and intentions towards Israel. It may also need the Iranian equivalent of China's Deng Xiaoping to come to power to reconcile the country's political and religious drivers with the population's normal and expected desire for a greater range of economic products and services.

However, one of the key factors affecting the opportunities of growth in the future of the Iranian auto industry is the very low predicted rise in GDP over the next two years, about 2–3%, as extended political negotiations will probably lead to a slow reduction in the application of sanctions.

From the Iranian market's point of view, the biggest driver for different and new JVs will come from public opinion as they see the new and exciting car designs and opportunities that are available in the rest of the world. These more exciting products will make the current Iranian vehicle production, based on old designs, less desirable and unable to meet increasing domestic customer expectations or higher requirements of quality and reliability.

The new designs and proliferation of new models available in the rest of the world now, with their increasingly high-tech systems coupled with the reduction of 'development to production' new model product cycle times, represent a significant challenge for Iran. For example, the multi-model body construction facilities and lean-manufacturing techniques available to the major international manufacturers, are now very significant, and hence a valuable financial part and contribution of any potential JV negotiation with Iran. This will require the global position of Iran as a vehicle manufacturer to be a significant part of major international manufacturers' strategies for global products and manufacturing.

On a global basis, the vehicle manufacturing sector has surplus capacity, and with the greater expectation for new and regular introductions of new models, features and new technologies to satisfy consumer requirements and meet environmental demands, profitability is a major and increasing concern. Furthermore the political implications for the governments of nations that currently hold these new product facets and expertise, is the exportation of jobs to other parts of the world, with the economic and social impact of increasing unemployment in the 'home' countries.

Tata Motors of India, rated as the 17th world major vehicle manufacturer, associated with a disappointing product reputation and low brand image, now owns Jaguar Land Rover (JLR), an upscale company with a global reputation, after purchasing it from Ford for £1.15 billion. Tata now has three internationally known brands in their automotive portfolio: Jaguar, Land Rover and Range Rover. This acquisition has transformed the future of JLR with the significant new investment funding that Tata brought, but it has also raised the profile and reputation of the Tata brand itself by association. Huge investments in design and quality have transformed JLR into a highly sought-after international brand.

The Iranian domestically produced vehicles are identified under their own badges/brands, and would need significant development in terms of quality, reliability and sophistication to become viable and significant exportable products, based on the Tata experience.

For SEAT in Spain, or Skoda in the Czech Republic, it took a significant relationship with Volkswagen to produce a competitive international product, with acceptable quality and reliability, thus allowing them to become major exporters of vehicles. These brands are now part of the Volkswagen AG portfolio of vehicle companies.

### **4.3. Developing the Retail Operation**

A strong automotive dealer network is absolutely necessary for the retailing of cars or commercial vehicles, as manufacturers do not sell directly except into business fleet markets, where financial concepts such as leasing are highly developed in some countries, and where specialist leasing and vehicle management companies provide full-service operations, acting as multi-manufacturer agents for their corporate clients.

Just as in any mature and stable economy, the country's automobile manufacturing is a very important part of that economic wealth generation, but equally manufacturers must have an excellent route to market. This is normally via a dealer network, and such a network of distributors is especially important if manufacturers want to be successful in selling into overseas markets.

If Iran's automakers want to develop significant sales opportunities in Western markets, consideration will need to be given to the current business models employed across international markets. The sort of globalisation seen with many consumer brands, where the producer's brand is prominent but the ownership is a local franchise (Kotler, Armstrong, & Harris, 2013), has not affected automotive dealer chains where each country tends to have its own brands of dealer chains and networks, with the dealer owner's name providing local brand image along with the manufacturer's own brand image providing consistency and continuity across international borders.

Decisions about the development of dealer operations in international markets depend on factors such as the manufacturer's own globalisation strategy; economies of scale; the use of specialist skills and capabilities; the ability to transfer the intangible elements of the brand and the exploitation of competitive advantage (Kent & Omar, 2003).

While US manufacturers have not often pursued the global product brand concept in terms of vehicles, the Japanese have been particularly successful at the internationalisation of harmonised model ranges and vehicle brands. Latterly European product brands such as Jaguar Land Rover, under the ownership of the India-based

Tata Corporation, have been extremely successful in penetrating and developing overseas markets, building dealer networks to sell and service vehicles to an extremely high standard (Drummond & Ensor, 2005). Sometimes, manufacturers have acquired all or part of dealer networks, as Mercedes has done in Europe, and placed them under direct control.

Dealer networks normally employ more people than the manufacturer, and investment by the dealer network is very expensive. Returns in the network are small by comparison to many other businesses, typically profitability can be as low as 0.5% of turnover, with a higher return normally for prestige marques (BMW, Audi, Mercedes for example) of around 3%. This equates to a dealership say with a turnover of \$30 million at the lower level of 0.5% retuning a profit of only \$150K, on the upper figure of 3% this gives a profit of \$900K.

With the level of profitability being so low, dealerships have to be managed on a micro-management style, with dealerships investing in the latest technology with Dealer Management Systems (DMS) that monitor every part of a dealership's function, from the moment a potential customer (prospect) makes contact through to the final sale.

This makes the non-sales aspects of dealer operations such as servicing and parts an important element of overall dealer profitability and cost centre management.

The DMS also provides very important live information on the dealership's performance; DMS systems are a manufacturer recommended system and the dealer has very little choice in terms of programme selection. The system normally links into the manufacturer's IT system and is monitored by them.

In recent years, major manufacturers such as GM and Ford in the United States have invested heavily in integrated procurement systems which enable dealer orders (or online customer orders) to be harmonised with back-office Customer Relationship Management (CRM) systems, such as accounting, and with production scheduling. These systems are thus integrated with those of component suppliers in order to achieve standards such as Just-in-Time (JIT) component deliveries to manufacturing or assembly lines (Kotler et al., 2013).

Dealers also have to comply with rigorous manufacturer standards that are inspected at regular intervals by the manufacturer or an agency working for them.

These standards control all aspects of the dealership: signage, systems, training, décor, advertising and marketing, even sometimes the showroom facilities.

The dealership will receive a very small discount on the product (the automobile) say 2–4%, an additional larger margin is paid to the dealer for achieving the sales target (set by the manufacturer) and the standards inspection. Customer feedback also monitored by the manufacturer contacting the dealership's customers and if all of these standards are achieved by the dealer the dealer then gets a back-end payment of approximately 8–10% paid as a bonus.

As one can see missing a sales target or not achieving the standards is of paramount importance to the dealerships, if these are missed as previously mentioned with the very low profitability the dealership would soon be in a loss-making situation. This explains in part why some dealerships retain multiple franchises from two or more manufacturers, though not all manufacturers allow this.

With the forgoing it is very difficult to understand why anyone would want to invest in motor dealerships. The fact is that many dealerships have evolved over many years, often as family-owned businesses but increasingly as part of larger conglomerates, and have grown with the controls exerted by the manufacturer. For Iran's automakers to develop a significant dealership operation in international markets, large investments and collaborative partnering will be required, perhaps on a JV basis.

Most manufacturers have a dealer council. The officers of the council are elected each year by the dealer network and they work closely with the manufacturer to represent the dealer network's views and difficulties. Usually it is a two-way relationship exhibiting aspects of permission marketing (Godin, 2001) where the dealer council and the manufacturer will negotiate to arrive at a win-win arrangement, possibly a compromise between what the manufacturer wants and what the dealer wants, and sometimes a dictate from the manufacturer.

As stated above, manufacturers sometimes have their own wholly owned dealer network, or part of a network. These dealerships are supposed to be profitable but as they are owned by the manufacturer they can adopt a loss-leader strategy (Kotler et al., 2013) if market penetration and volume sales are a short-term objective. This may take place at the expense of independent dealers that are also in the manufacturer's network. These dealerships are viewed by the independent network with great suspicion and in most cases excluded from the dealer conferences held by the dealer council. In overseas markets, manufacturers sometimes take direct control of dealer ownership in order to achieve consistency in management and branding.

#### **4.4. Manufacturing — Sophisticated, Lean and Just in Time**

The withdrawal of companies such as Peugeot-Citroen and Renault following the imposition of sanctions in 2012, led to not only a dramatic fall in production but, more significantly, the beginning of a downward spiral in manufacturing quality. This has had an increasing impact on the design and quality of vehicles, exacerbated by the fact that the Western cars being produced on Iranian assembly lines were, in the main, older models no longer current in Europe.

The following detailed analysis of modern manufacturing techniques and vehicle components reveals the level of catching-up required if Iran wants to become a serious player once again in regional and international export markets. These factors



apply to many of Iran's technology-based industries and hence represent a significant challenge and, at the same time, a major opportunity for Iran's engineers and political leaders.

The current vehicle construction systems for high-volume products are based on monocoque<sup>1</sup> designs that rely on thin low weight stampings, being welded or glued together to achieve stiffness and rigidity in the final assembled body structure. Current designs use different steels, with different strength and durability requirements, and the progressive introduction of aluminium components to reduce weight, for the overall benefit of vehicle fuel efficiency. These steel products are in many applications required to be either single sided or coated on both sides with zinc or other treatments to reduce the corrosion potential of the final vehicle structure. Such steels and the inclusion of aluminium components lead to assembly issues, in terms of joining together by welding or adhesives.

The requirement for many different body styles to provide the total volume of a manufacturers economic output, has resulted in standardised platforms (taking the engine, transmission, driveline and suspension), being dressed with different 'super-structures' to make saloons/sedans, estate cars, coupes and cabriolets or convertibles. In order to achieve JIT manufacturing, with minimal stock piling within the plant systems, requires body construction tooling and robotics that facilitate the processing of the required range of body styles on preferably a single body assembly line, or lines to facilitate required manufacturing plant cycle times. With the thinner body panels required for vehicle weight reduction (necessary for fuel economy requirements) the construction system has to avoid panel damage, in the form of dents, scratches or distortion, that create the need for repair or refurbishment before the commencement of pre-treatment and paint operations. Hence to maintain the JIT production schedule first time quality capability from the Body Shop has to be 97–95% minimum.

With the thinner panels and inclusion of coated steel and the use of aluminium in the body structures, the importance of the paint system is paramount, in securing corrosion resistance (most manufacturers provide a minimum anti perforation warranty — for example, Mercedes provide a 30-year warranty on their products). Where steel and aluminium are used together the added need to provide anti-galvanic insulation in service is similarly essential. All body structures need full and

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<sup>1</sup>A monocoque design refers to a body shell to which all the vehicle's components are attached. This technique involves creating components and indeed complete vehicle body shells by the use of press stamped thin section ferrous and alloy-based materials joined together by welding or adhesives, to create light weight torsionally stiff and robust structural assemblies. This is a term also related to the current trend for vehicle bodies to be 'unibodied', which uses a series of monocoque subassemblies to supersede the traditional methods of a separate chassis carry suspension and driveline components, to which a separate body shell is attached often affected by mechanical fasteners.

comprehensive cleaning systems ahead of pre-treatment that will use phosphates for steel-based structures and passivisation<sup>2</sup> on other alloys.

They key part of this process apart from the anti-corrosion properties is to provide a surface structure that produces a 'sticky' and microscopically rough surface to enable the subsequent electro-coat treatment paint particles to better adhere. Following the pre-treatment, the bodies are dipped in cathodic electro-coat,<sup>3</sup> which enables the water-based paint particles to be 'electro-plated' onto the inside and outside of all of the monocoque sections that make up a body shell. Subsequently the body shell is cured in an oven that will operate in the temperature range of 180–200°C. This process enables the paint particles to 'flow' providing a smooth surface for subsequent priming and top-coat paint operations, with minimal process repairs. The electro-coat curing process will also activate the stiffening of special steel sections that will harden during this process.

With a pre-treated, and electro-coated body shell, the subsequent operations to turn the body into the customers' desired colour commence with the initial use of a base primer to prepare the surface for the top coat. In the past most of these systems were based on solvent-based technologies, but now increasingly for environmental needs to reduce solvent (VOC) escape into the atmosphere, water-based technologies are used with robotic electrostatic facilities to achieve consistent and correct thickness coverage of primer and top-coat paints. Between priming and top-coat operations the bodies are again oven cured to ensure a smooth flow out of the prime paint coat, before commencing top-coat operations. Most current top-coat systems are based on a system called 'Base Coat Clear'. This requires a base colour coat using water-based technologies electrostatically applied for good wrap around robotic application, leading to correct application thicknesses and consistent spray patterns for good image clarity and structure. Subsequently a clear coat robotic operation is used, that is solvent-based to provide the 'gloss' finish and provide the required image depth needed especially for metallic paints, and the protection from the elements and daily exposure to the environment.

It is critical that the first time capability of the finished products coming from the Paint Shop be very high (97–95% minimum) so that the JIT process of production scheduled orders started in the Body Shop is maintained through the Paint System.

Having maintained the planned JIT schedule orders through the Body Shop and Paint Shop, the ability to advance final forecast to the suppliers, the right parts required on the Vehicle Trimming and Final Assembly on a JIT basis is guaranteed, to meet expected customer delivery dates.

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<sup>2</sup>Passivisation refers to the chemical treatment of a metal surface, to prevent premature oxidation, and render the surface ready by an etching process for further decorative finishes to meet design, durability and appearance criteria.

<sup>3</sup>*Cathodic electro-coat* is a process used in the preparatory preservation of metal structures to prevent surface and internal section corrosion.

The key issue of this JIT production process is to guarantee extremely high first time quality results at each stage of the production system as well as the required standards of fit, finish and functionality that create the customer's expectations and perceptions of a high-quality product.

#### ***4.4.1. The Importance of Quality in the Brand Proposition***

Almost all of the improvement in quality comes via the simplification of design, manufacturing, layout, processes and procedures (Peters, 1985). In auto manufacturing as in other industries, organisations have over the years developed different management systems to improve and monitor quality standards. Sometimes this is a rational process in pursuit of strategic goals, and at other times a desire to meet the social and relationship expectations of industry partners or even competitors. Research by Zhang, Linderman, and Schroeder (2014) indicates that it is the rational objective which mainly drives improvements to quality management, but that the social aspect affects some organisations as well. However, performance enhancements arise from a focus on rational quality objectives. It may well be that the social aspects lead to improved market share and better channel-to-market relationships, using elements of relationship marketing.

Relationships are also important in the supply chain. With procurement systems increasingly being harmonised between manufacturer/assembler and suppliers, the nature and quality of the relationship is becoming critical to the maintenance of supplier quality of products and services. Research by Kang (2012) suggests that one of the key elements in maintaining this relationship is the manufacturer/assembler's policy on payments in terms of consistency of cash flow and payment times. The recession in Western economies since 2008 has prompted many companies to extend payment times, but this has a detrimental impact on suppliers and, in turn, the quality of the products and services they provide. It has a longer-term detrimental impact on the nature and quality of the relationship.

A further important aspect that has been problematic for global automakers in the past few years has been the high number of recalls. As the number of auto component suppliers has fallen significantly to the position where a dozen or so suppliers are providing the majority of parts for auto assembly lines (although Japanese transplants still also make use of locally based suppliers), the costs to automakers of recalls are rising and some manufacturers have failed to make recalls in the hope of saving costs. The legal implications of this can be costly, however. In the United States, Toyota was fined \$1.2 billion in 2014 for concealing information about the safety of over 10 million cars. GM waited 11 years to recall millions of models with faulty ignition switches, a defect which has allegedly led to a number of deaths (Schmidt, 2014).

Honesty and integrity in recall management are an important part of the brand promise, and customer trust and loyalty, in an era when automobiles are highly sophisticated, well-engineered and manufactured to extremely high standards.

#### ***4.4.2. The Influence of the Japanese***

One of the key influences over the past 20 years has been the influence of Japanese practices in auto manufacturing quality. Their production system arose from an emphasis on Quality, Cost, Delivery and Excellence in product design, development, materials management and highly efficient production systems (Shimokawa, 2013). They have brought enormous improvements to design, manufacturing and production with their programme of lean manufacturing and the implementation of international transplants of manufacturing facilities, along with the creation of locally based supplier relationships. Practices such as JIT, Kaizen and Kanban have revolutionised the efficiency and quality of auto production (Kato & Smalley, 2011; Stewart, 2012).

In the future, there will be excellent opportunities for collaboration, as well as with US and European automakers who now have a well-developed history of collaborating with Japanese companies themselves, giving rise to a new world of multi-layered international collaboration where the implementation of relationship marketing and other management practices will be key to success in the global auto business of the future.

#### ***4.4.3. Additional Manufacturing Considerations***

With the availability of high-quality light weight body shells, fully painted, in the required optional body styles, the other areas of manufacturing come into play. These include the provision of power-trains including engines, transmissions and axles. Traditionally, high-volume major manufacturers prefer to have control of their own facilities for manufacturing these components, as this is the major area of reliability that influences reputation, and subsequently, low warranty claims. The drive for lower vehicle weights to maximise fuel economy has resulted in the major move to using aluminium-based alloys for the structural components like engine cylinder blocks and transmission/axle cases. The switch from traditional ferrous casting systems brings its own level of key expertise and product knowledge in the manufacturing processes.

With the continual drive for improved fuel efficiency and reliability, the use of real time computer systems measuring and adjusting the features of fuelling, ignition timing, valve timing, exhaust emissions, responding to atmospheric conditions and feedback from the vehicles transmission sensors, to name but a few, are an essential and critical part of the modern car's requirements. When the other interfaces like chassis monitoring for control of suspension damping; braking of individual axles to improve dynamic stability, and torque vectoring, as well as compensating for road conditions to provide smooth and flat rides, especially while cornering, the computer-based expertise from the designers in the vehicle company's own staff, as well as the component and system manufacturer who provide this componentry and

sensors within say suspension systems, is a key and major part of the vehicle's quality and performance reputation portfolio.

An example of the change in the impact of this side of vehicle design can be illustrated simply by the automatic transmission. Forty years ago, manual transmissions were credited with providing better fuel economy and performance, now with the automatic transmissions' own electronics making the transmission changes happen, the ability to feedback into the engine systems, gives automatic cars improved fuel economy over manual vehicles. Indeed the latest iteration of Porsche's 'race car for the road', the 991 Model 911 GT3, is now only supplied with a dual clutch automatic transmission, leaving behind the 'only manual transmissions on a GT3 rule' for all of the previous iterations of this iconic Porsche model.

Other areas of the modern car design call in equally significant manufacturing expertise whether 'in house' at the vehicle manufacturer or from long-term commercial relationships with preferred suppliers. These areas can range from brake systems (ABS 'Brake Assist', etc), to vehicle glass, and the provisions of the now familiar integrated vehicle moulded dashboard, trim feature on doors, centre consoles, etc. Vehicle seats are now a major part of the vehicle image, comfort and electric convenience (heated and ventilated), of automatic adjustment memories, linked to the vehicles keys or door entry electronics. Sound insulation and the avoidance of road and wind noise, are now major parts of vehicle comparison by customers and motoring pundits. We are also now aware of a push towards hybrid engine technologies, as well as systems that insulate the driver from the changing road conditions, whether as a result of fog, other road users or just congestion. The switching off of engines when the vehicle comes to a halt in traffic is now commonplace in most makes and models, together with automatic headlight illumination.

As a result of these changes in the modern vehicle, the costs of creating and operating JVs have increased substantially. Developing countries seeking to establish their own vehicle manufacturing base, thus face far more expensive projects, compared to a not too distant past when vehicle technology was much simpler, and customers were less demanding and had lower expectations.

Whether the local Iranian vehicle industry can get to this level of modern current vehicle technology without new JVs, remains to be seen. The nature of current international sanctions may also preclude many of these new technologies, which could have military applications, being made available to Iran.

The next step in vehicle automation will be to progressively introduce driver-less controls such as braking, speed and distance between vehicles. The technology already exists for these systems, but driver resistance will delay their introduction.

#### ***4.4.4. Politics and Relationships in Joint Ventures***

Experience has shown that successful collaboration in automotive JVs, which requires supporting local manufacturing, and facilitating manufacturers and suppliers transfer of technology is a challenging task. External factors, such as the impact of international politics can certainly have an impact. However, at the managerial

level, personal relationships constitute a major factor in the successful execution of a project.

Many will recognise the maxim of the JV trading partner of ‘they want your money, they want your technology and they want you out!’. Given a grasp of national pride, this can be understood, and with the right personal relationships, carefully developed, it can be managed and accommodated.

It is critical to maintain a major management role in the financial control of the enterprise and the JV or technology transfer arrangements must reflect this key requirement. Without this, it is easier for the ‘money to run out of the hole in the bottom of the bucket’, especially if some key local or national relationships need financial lubrication.

Expatriate compensation often represents a significant cost for the local JV partners. It is therefore important that foreign specialists be hard working and diligent at all times to provide in excess of the service expected. This does make strong local relationships a reality, and ensures trust can be established, thus ensuring the successful operation of the JV or Technology Transfer.

Another area where expertise is often required is to get a good picture of the market to be supplied and the derivatives that are needed to meet the budgeted manufacturing volumes. In Europe and the United States, reliable sources of data are available to predict the areas where products are needed and hence establish target volumes for the manufacturing operation. In less developed markets, establishing what is needed is often not supported by clear national marketing data. In these circumstances, it is often necessary to spend weekends in different provinces and cities, literally sitting on a street corner doing ‘vehicle counts’ by type and configuration, to estimate the market needs and requirements. Collection of such primary data is crucial for success of an operation. The key is to ensure that all decisions on the local manufacturing opportunity are data driven.

Sometimes a JV between a global company and a country’s local manufacturers are required by law, as in the case of India. At other times, global alliances have been driven by technical collaboration and the sharing of components, even amongst major manufacturers. There has also been international merger and acquisition activity, as in the case of Nissan acquiring Renault, or the Tata Group acquiring Jaguar Land Rover, BMW acquiring Rolls-Royce and Volkswagen acquiring Bentley, adding product width and depth to their other European brands such as Audi, Porsche, SEAT and Skoda.

However, these former alliances are now changing in nature as automakers collaborate on emergent technology, playing to their own strengths. For example, Honda are collaborating with GM because GM needs the efficiencies arising from Honda’s short lead time production system, and Honda needs GM’s expertise in advanced fuel cell design and manufacture (Shimokawa, 2013). For the Iranian automakers, there will be enormous opportunities to collaborate on many different levels in international markets, from supply chain management, design and manufacture/assembly, through retail channel management and distribution systems.

## 4.5. Conclusion

Iran has a long history in automotive production. The lifting of sanctions would open the door for opportunities to explore JV partnerships with a range of Western auto manufacturers who could bring the latest technology and manufacturing techniques, and the managerial know-how to produce vehicles that will be able to compete in world markets. Domestically, there are opportunities for enhanced employment, especially for young people, along with its associated upskilling and prospects for personal training and development.

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## Chapter 5

# The Iranian Diaspora as a Conduit for Western Technology, Capital, and Know-How to Revitalize the Iranian Economy

Dino N. Bozonelos

### Abstract

This chapter seeks to highlight the important role that the Iranian diaspora will have in a post-sanctions Iranian economy by mapping its political economy. In a 10-year period of analysis, I show that Iran remained a mostly patrimonial state that also became slightly less statist over, yet showed the potential for liberal economic reform. Thus, even though Iran may seek to incorporate liberal economic policies, patrimonial and statist elements will remain quite strong within Iran's economy for years to come. The key asset of the Iranian diaspora then will be its integration with Western societies. This depth will allow expatriates to bridge the information gaps that will undoubtedly develop as foreign direct investment increases. Most foreign firms will find this expert guidance quite valuable when attempting to navigate the Iranian political economy.

**Keywords:** Iran; diaspora; political economy



## 5.1. Introduction

The election of Hassan Rouhani in 2013 marks a new era in Iran. As president, Rouhani has made the development of the Iranian economy his top priority. And for Rouhani, growth can only occur if Iran is reintegrated into the world economy. Rouhani succinctly verbalized his foreign and economic policy agenda in January 2015 when talking to hundreds of Iranian economists and business leaders. He stated, “By God, by Lord, it is impossible: the country cannot have sustained [economic] growth when isolated” (Paivar, 2015). Indeed, he even suggested that a popular referendum be held on Iran’s nuclear status should hardliners attempt to stymie any progress toward the policy goals (Cole, 2015). Given Iran’s convoluted legislative process, it would be unlikely that such a referendum would take place. Yet even if such a referendum were never come to pass, Rouhani’s bold statements are what I believe are the beginning stages of a fundamental shift in Iran toward rapprochement with the West and the eventual liberalization of Iranian markets. This shift will create the conditions for the Iranian diaspora to become a conduit for technology, capital and know-how to revitalize the Iranian economy.

## 5.2. Political Economy and Its Importance for Understanding Iran

An attempt to understand the type of political economy that may prevail is important as the political-economic structures within a country often “sets the rules for the game.” By this I mean the formal rules set forth by the political authorities for business relations in the Islamic Republic of Iran. However, there also exists a large informal sector within Iran, which often challenges the more formal economic institutions for importance. Thus, looking at the formal and informal rules of the game is important for external economic actors. Knowing what it takes to invest in Iran from a foreign perspective, is qualitatively different than from a domestic perspective.

This linkage between politics and economics, as exemplified in Rouhani’s quote, has been well understood. While classical studies of scholarship often discussed the primacy of the political side of the relationship, contemporary scholarship places the emphasis on the economic sphere (Caporaso & Levine, 1992). More modern scholars, such as Caporaso and Levin go further (1992). They explain that “The economic approach explains what we do and why we do it. Politics (for them) simply describes the context.” This attention to the “economic calculations” of rational actors went hand-in-hand with the spread of liberal market principles or capitalism since the end of World War II. Scholars went from talking about how institutional action, such as government interference, affects the market, to talking about how the market *is an institution*, with its own set of rules and formalized members. Hall and Soskice (2001) help us understand this dynamic by developing a firm-centered

framework for understanding capitalism. In their framework, referred to as the Varieties of Capitalism theory (VoC), firms are considered the primary rational actors within an economy. They interact with each other in various spheres of the political economy and their aggregate behavior becomes the basis for understanding the macro-economy of a particular country. According to an associated article by [Hall and Gingerich \(2009\)](#), these spheres can range from financial markets to industrial relations to education and training to interfirm relations to product markets and finally to firm–employee relations.

Their conceptualization of the way firms behave when attempting to coordinate their endeavors across the various spheres allows for the classification of developed countries along an axis defined on the one side by a liberal market economy (LME) and on the other by a coordinated market economy (CME, and also referred to as a corporatist economy). Countries where firms depend more heavily on market mechanisms to solve coordination problems are considered to have an LME.<sup>1</sup> When firms instead rely on strategic cooperation between important constituencies, and collaboration that is often industry-specific, to solve coordination problems, they operate in a CME.<sup>2</sup> More importantly, Hall and Soskice expound on the relevance of institutional complementarities. They suggest,

that nations with a particular type of coordination in one sphere of the economy should tend to develop complementary practices in other spheres as well. (Hall & Soskice, 2001, p. 18)

For the authors, this means that if market competition exists as the solution to coordination problems within industrial relations, then it will most likely also be the solution for coordination problems in regards to education and training of employees and when understanding interfirm relations.

Hall and Soskice then can tell us how political-economic systems look like such as the United States and/or Germany, and consequently how multinational corporations should expect to operate within those countries if they want to succeed. However, their framework falls short of explaining the state–market interactions within developing countries, such as Iran. Indeed, it would be difficult to classify Iran as either an LME or a CME. Both political economy types assume that the firm has the autonomy and the capacity to act rationally within the spheres of an economy, usually without distorting interference by state institutions (often referred to market liberalization). In regards to Iran, firm behavior is quite limited and interaction between firms is largely determined by both formal and informal state institutions. Indeed, [Manktelow \(2014\)](#) writes in his book, the *Guide to Emerging Markets: The Business Outlook, Opportunities and Obstacles*,

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<sup>1</sup>LME countries include the United States, the United Kingdom, Australia, Canada, New Zealand, and Ireland.

<sup>2</sup>CME countries include Germany, Japan, Switzerland, the Netherlands, Belgium, Sweden, Norway, Denmark, Finland, and Austria.

the operating environment is challenging and subject to political interference, and foreign companies are likely to be used as scapegoats for increased international pressure on Iran. State enterprises have privileged positions in most sectors and preferential terms for foreign exchange. (pp. 180–181)

Given that Iranian firms currently lack the autonomy and capacity for action, I turn to a recent work by Becker (2014) to better understand the political economy of Iran and how the Iranian diaspora can position itself to help revitalize the economy. Becker's book is a powerful approach from which to understand the political economy of developing countries such as Iran. What Becker does is depart from the binary axis provided by Hall and Soskice where market economies can be classified as either liberal or coordinated/corporatist.<sup>3</sup> Instead, Becker expands upon the typology in order to understand the exemplary economic growth of the BRICs, an acronym for Brazil, Russia, India, and China. As none of these four countries can be properly classified on the liberal/corporatist binary axis, Becker develops three more types, which better explain what one sees in the BRICs.

Thus, in addition to the LME and CME (called corporatist by Becker), there are the statist type, the patrimonial type, and the meso-communitarian type. A statist political economy exists when the controlling political authority regulates the market to determine the course of the economy. In the statist type, state-owned firms are often prominent. Patrimonial political economies, also referred to as crony capitalism, are based on patron–client relationships. Corruption, favoritism are present and the interactions between actors are quite specific. A meso-communitarian type of political economy is where networks of firms are organized into communities. These communities then provide the social welfare services that in most other political economy types are delivered by state institutions.

Also, what Becker does is conceptually allow for elements of all five types of political economy to be present within a country, which is the case for all developing countries including Iran. This approach is also key for understanding the Iranian political economy as it allows for understanding how change, especially in regards to the incorporation of liberal market reforms, is taking shape. Reforms will most likely take place if sanctions are lifted in the event of a U.S.–Iran negotiated settlement on Iran's nuclear policy regime. Again Becker notes, the VoC approach struggles conceptually with change within a political economy. For example, the author notes even though Western capitalism was organic in its

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<sup>3</sup>In fairness to Hall and Soskice, they write that six OECD countries are in “more ambiguous positions,” including France, Italy, Spain, Portugal, Greece, and Turkey. They suggest that they may constitute another type of capitalism and provide the appellation of “Mediterranean” to describe their political economies. However, this Mediterranean axis is not explored further in their work. Instead, their chapter on the political economy of France focuses on the liberalization of the French economy, hinting that France is converging toward an LME type.

formation, its use as an economic system of preference was implemented by policymakers in the United Kingdom and the United States over the past two centuries. In addition, the degree to which a country would liberalize or de-liberalize, most often depended on the ruling party of the particular country, especially since the end of World War II. Thus, we will see in Iran what is seen in other countries that have liberalized their economies, “processes of societal trial and error (that) are the social form of natural selection” (Becker, 2014). Thus, the technology, capital, and know-how needed to revitalize the Iranian economy will depend on the pathways created through this “natural selection process,” which situates the Iranian diaspora in a good position to shape these pathways.

### 5.3. The Political Economy of Iran

As noted, it is likely that Iran will feature elements of at least four political economy types: statist, liberal, patrimonial, and corporatist. More than likely, Iran will not feature elements of the meso-communitarian type as few countries do. The question then is how statist/liberal/patrimonial/corporatist is Iran? Again, I turn to Becker and use his framework for the analysis. Becker uses four different indices when categorizing the BRICs. However, unlike the author, I am only able to use two of the indices: the Index of Economic Freedom (IEF; Heritage Foundation and *Wall Street Journal*), and the Worldwide Governance Indicators (WGI; World Bank). The other two indices are produced by the Organization for Economic Co-operation and Development (OECD), of which Iran is not a member.<sup>4</sup> Still, the scores generated from the IEF and the WGI can help in providing a rough understanding of Iran’s political economy.

The IEF scores should be able to help us partially understand how liberalization looks like in Iran. I say partially as the IEF scores allowed Becker to place the BRICs on an axis of liberal and embedded political economy types. In addition, the WGI scores can help us understand statism and patrimonialism in Iran as well. Though, without the scores produced by the OECD indices, I will be unable to use Becker’s formal model to quantify the levels of statism and patrimonialism in reference to liberalism. Becker defines both statist and patrimonial economies as embedded economies, which he then graphs on varying axis.

In regards to the IEF scores, Becker combines and drops some of the 10 indicators within the IEF to create 5 relevant indicators. The five indicators he uses are: business freedom; an average of fiscal freedom and government spending; financial freedom; and average of investment freedom and trade freedom; and freedom from

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<sup>4</sup>The two OECD indices that Becker uses in his analysis of the BRICS are the Product Market Regulation Index (PMR) and the Employment Protection Legislation (EPL).

corruption.<sup>5</sup> In addition, when Becker calculates the average country score for the BRICs, he only uses 50% of the average of the combined fiscal freedom and government spending indicators. He argues that in respect to those two indicators, taxation and government spending levels are always low in developing economies. Table 5.1 lists the average country score for Iran using the five selected indicators with 1998 and 2008 as the comparison years. I also include the indicator scores for the BRICs as calculated by Becker for comparison purposes. Higher numbers indicate more freedom specific to the indicator.

Table 5.1 shows that in 10 years the Iranian economy had become more liberal, moving from an average country score of 27.8 in 1998 to 33.6 in 2008. The indicators with the most movement are freedom from corruption and the average of the fiscal freedom and government spending indicators. In regards to the freedom of corruption indicator, Iran had become less corrupt, moving from a score of 10 in 1998 to a score of 28 in 2008. This score is relative though, as a score of 100 would indicate very little corruption. Therefore, a score of 28 still means that Iran

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<sup>5</sup>The following definitions for each freedom is taken directly from the 2014 Index of Economic Freedom website ([Heritage Foundation, 2014](#)):

*Business Freedom:* A quantitative measure of the ability to start, operate, and close a business that represents the overall burden of regulation as well as the efficiency of government in the regulatory process. The business freedom score for each country is a number between 0 and 100, with 100 equaling the freest business environment.

*Fiscal Freedom:* A measure of the tax burden imposed by government. It includes both the direct tax burden in terms of the top tax rates on individual and corporate incomes and the overall amount of tax revenue as a percentage of GDP.

*Government Spending:* This component considers the level of government expenditures as a percentage of GDP. Government expenditures, including consumption and transfers, account for the entire score.

*Financial Freedom:* A measure of banking efficiency as well as a measure of independence from government control and interference in the financial sector. State ownership of banks and other financial institutions such as insurers and capital markets reduces competition and generally lowers the level of available services. In an ideal banking and financing environment where a minimum level of government interference exists, independent central bank supervision and regulation of financial institutions are limited to enforcing contractual obligations and preventing fraud. Credit is allocated on market terms, and the government does not own financial institutions. Financial institutions provide various types of financial services to individuals and companies. Banks are free to extend credit, accept deposits, and conduct operations in foreign currencies. Foreign financial institutions operate freely and are treated the same as domestic institutions.

*Investment Freedom:* In an economically free country, there would be no constraints on the flow of investment capital. Individuals and firms would be allowed to move their resources into and out of specific activities, both internally and across the country's borders, without restriction. Such an ideal country would receive a score of 100 on the investment freedom component of the Index of Economic Freedom.

*Trade Freedom:* A composite measure of the absence of tariff and nontariff barriers that affect imports and exports of goods and services.

*Freedom from Corruption:* Corruption erodes economic freedom by introducing insecurity and uncertainty into economic relationships. The score for this component is derived primarily from Transparency International's Corruption Perceptions Index (CPI) for 2010, which measures the level of corruption in 178 countries.

Table 5.1: Index of economic freedom for Iran and the BRICs.

	Average		Business Freedom		Avg. of Fiscal Freedom and Govt. Spending		Financial Freedom		Avg. of Investment and Trade Freedoms		Freedom from Corruption	
	1998	2008	1998	2008	1998	2008	1998	2008	1998	2008	1998	2008
Iran	27.8	33.6	55.0	55.8	63.2	82.8	10.0	10.0	32.5	33.7	10.0	27.0
Brazil <sup>a</sup>	45.5	44.1	70	54.0	81.6	62.0	33	40	53.9	65.6	30	33
China <sup>a</sup>	39.6	40.5	55	50.3	88.2	78.1	33	30	42.0	50.1	24	33
India <sup>a</sup>	36.4	42.3	55	50.9	78.5	74.6	30	30	31.6	60.5	26	33
Russia <sup>a</sup>	48.1	38.6	55	53.7	70.8	74.4	70	40	54.3	37.1	26	25

<sup>a</sup>Data for Brazil, China, India, and Russia are taken from Table 2.1 in Becker's book (p. 41). I include it for comparison purposes.

remained corrupt, just not as corrupt as it was 10 years ago. When looking at the average score of the fiscal freedom and government spending indicators, it appears that Iran is taxing and spending less than it did before. This is the opposite trend of what happened in Brazil, China, and India. As mentioned above, low taxation and government spending levels are quite emblematic of a developing country. Many developing countries tend to lack a proper tax base and struggle to identify spending priorities. Thus as a country's economy develops, one should see taxation and government spending levels increase commensurate with a country's wealth. Since the score for Iran increased, it could have indicated that taxation and government spending levels decreased as a percentage of GDP. If so, then this is a worrying sign.

Granted, when it comes to measuring liberal change in the Iran, the bar is set quite low. The [Heritage Foundation \(2014\)](#) has always considered Iran to be repressed in their country ranking categories. Indeed, in 2014 Iran was ranked 173 out of 178 countries in the index with an overall IEF score of 40.3. This is 20 points lower than the world average score of 60.3 and the regional average score of 61.5. And it pales in comparison to the 84.1 average score of economies the Heritage Foundation classifies as free. However, when comparing Iran to the BRICs, Iran has liberalized quantitatively more than China, Brazil, and Russia, with a positive change of 5.8%. Only India showed more liberalization with a change of 5.9%. Again, Iran is starting from a low point, but it did move in a liberal direction during those 10 years.

In regards to the scores for the WGI, Becker uses four indicators. These include indicators for government effectiveness, regulatory quality, rule of law, and control of corruption.<sup>6</sup> The first three of these indicators are used to roughly develop a measure for statism, which is why Becker averages them to produce a comparative metric. The WGI project scales each indicator between 2.5 and -2.5. Becker converts the scale to 0-100 for the average. I do the same for Iran. As mentioned before, the statist type of political economy is where the state restricts the market through political regulation to best determine the course of the economy (Becker,

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<sup>6</sup>The following definitions for each WGI indicator are taken directly from the WGI website ([Kaufmann, Kraay, & Mastruzzi, 2015](#)):

*Government Effectiveness:* Captures perceptions of the quality of public services, the quality of the civil service, and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.

*Regulatory Quality:* Captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.

*Rule of Law:* Captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.

*Control of Corruption:* Captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests.

2014). Given this definition, state intrusion exists in both liberal and coordinated market economies. Indeed, a functioning market should exhibit high levels of government effectiveness, regulatory quality, and rule of law. Investors tend to prefer a stable market to an unstable market. This explains why the United States and France score high in the WGI. However, the difference involves the comparison of the metrics between statism to the liberalism. For example, the United States scores high as well in regards to its economic freedom indicators. When coupled with the high scores for the world governance indicators, one can assume that U.S. regulatory policy exists to promote and sustain liberalism. When looking at developing countries, one often sees that statism indicators are often higher than the indicators for liberalism. This suggests that domestic regulatory policy mostly does not exist to promote and sustain liberalism. It also often indicates that state-owned enterprises (SOEs) are present that compete with private firms for market space or crowd them out entirely.

Table 5.2 shows that Iran had become less statist, with an average score of 31.4 in 1998 to 29.3 in 2008. The indicators for government effectiveness and the rule of law shrank, meaning that perceptions of government performance and confidence in the rule of law worsened in 10 years. In contrast, perceptions of regulatory quality slightly improved. Regulatory quality looks at the ability of the government to implement policies that promote private sector development. As discussed above, this analysis is limited to the scores produced with the IEF and WGI indices.

Where I differ with Becker is that I convert the fourth indicator, control of corruption to roughly measure patrimonialism. Becker simply subtracts the level of statism from the extent of embeddedness, a metric produced using the OECD

Table 5.2: Worldwide governance indicators for Iran and the BRICs.

	Govt. Effectiveness		Regulatory Quality		Rule of Law		Converted Average of Previous 3 Indicators <sup>a</sup>	
	1998	2008	1998	2008	1998	2008	1998	2008
Iran	-0.46	-0.61	-1.73	-1.64	-0.61	-0.85	31.4	29.3
Brazil <sup>b</sup>	-0.13	0.00	0.44	0.07	-0.32	-0.37	50.0	48.0
China <sup>b</sup>	-0.14	0.19	-0.26	-0.16	-0.37	-0.34	44.8	48.0
India <sup>b</sup>	-0.06	-0.02	-0.36	-0.33	-0.28	-0.08	45.4	47.2
Russia <sup>b</sup>	-0.76	-0.37	-0.47	-0.45	-0.94	-0.96	35.6	37.8

<sup>a</sup>The WGI scale of -2.5 to 2.5 is converted to a 0–100 scale. -2.5 is converted into 0, 0 is converted to 2.5, and 2.5 is converted to 5. Each score is then multiplied by 20 (Becker, 2014).

<sup>b</sup>Data for Brazil, China, India, and Russia are taken from Table 2.4 in Becker's book (p. 45). I include it for comparison purposes.



indicators. As OECD statistics do not exist for Iran, rescaling the indicator that controls from corruption helps in comparing patrimonialism to liberalism and statism. Also referred to as crony capitalism, patrimonialism occurs when government officials exercise their powers to benefit themselves and their clients. These patron–client relationships then reinforce political leadership, making hard to shake off corruption. The metric for patrimonialism is calculated by adding 2.5 to the control of corruption score, and multiplying by 20. The relationship within the control of corruption score is inverted and therefore qualitatively different from the other WGI scores where the relationships are positively correlated. For example, higher levels of government effectiveness, regulatory quality, and rule of law are positively associated with higher WGI scores. This means that the higher the scores, the higher the levels of government effectiveness, regulatory quality, and rule of law. In contrast, the higher the WGI score for control of corruption, the lower the level of corruption present in the country. This same inverted relationship exists for the new patrimonialism metric.

With Table 5.3 we can see that Iran has become slightly less corrupt in the 10-year study period, with a score of 34.6 in 1998 and a score of 35.8 in 2008. Again, the scale is negatively correlated, which means the higher the number, the lower the level of corruption. Iran differs from the comparison countries as corruption has worsened in those states. What then do the descriptive statistics tell us about Iran? As expected, Iran remained a mostly patrimonial state that also became slightly less statist yet more liberal, where much of the movement occurred in the liberalism metric. Thus, one can make an argument that as an economy, Iran has the capacities to adopt more liberal reforms. This does not mean that liberal reforms have to occur. Indeed, the Heritage Foundation has concluded that Iran exhibited less economic freedom since the 2008/2009 global recession. However, with the election of Hassan Rouhani and the potential change in economic policies his administration

Table 5.3: Comparing liberalism, statism, and patrimonialism.

	Liberalism		Statism		Patrimonialism <sup>a</sup>		Control of Corruption <sup>b</sup>	
	1998	2008	1998	2008	1998	2008	1998	2008
Iran	27.8	33.6	31.4	29.3	34.6	35.8	−0.77	−0.71
Brazil	45.5	44.1	50.0	48.0	50	49.6	0.00	−0.02
China	39.6	40.5	44.8	48.0	45	41.2	−0.25	−0.44
India	36.4	42.3	45.4	47.2	44.2	42	−0.29	−0.40
Russia	48.1	38.6	35.6	37.8	31.2	29.8	−0.94	−1.01

<sup>a</sup>The WGI scale of −2.5 to 2.5 is converted to a 0–100 scale. −2.5 is converted into 0, 0 is converted to 2.5, and 2.5 is converted 5. Each score is then multiplied by 20.

<sup>b</sup>These are the original scores from the WGI dataset.

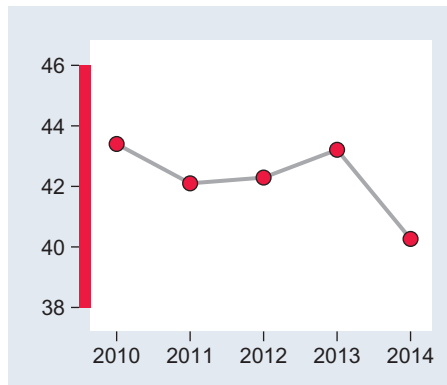


Figure 5.1: Recent IEF scores for Iran.

Source: Adapted from the “2014 Index of Economic Freedom” by the Heritage Foundation. Copyright 2014 by the Heritage Foundation.

could implement, the incorporation of liberal reforms in Iran looks more likely (Figure 5.1).

#### 5.4. The Iranian Diaspora: A Conduit for Inward FDI in Iran

Now that I have established that Iran is a mostly patrimonial political economy that has become slightly less statist with the potential for liberal reform, who will benefit the most from liberal economic reforms in Iran? The most obvious answer is the Iranian diaspora. The diaspora for Iran has its modern roots in the 1979 revolution, which saw Ruhollah Khomeini come to power as the head of an Islamic government. This upheaval in Iranian society saw a major exodus of highly skilled Iranians to other countries. Shoamanesh (2009) notes that the intellectual and economic elite left abruptly, leaving behind their possessions and property in the frenzy that ensued. For example, Hakimzadeh (2006) cites a report by the Iranian Ministry of Culture and Higher Education that in 1980 there were 16,222 professors before the Iranian universities closed during the revolution. Upon reopening, the number of professors had dropped to 9042. She also notes that there was anywhere from \$30 to \$40 billion in capital flight from Iran during the revolution. This brain drain has continued for the most part, though working-class Iranians also started leaving in the mid-1990s, moving for better economic opportunities. According to the World Bank, there are 1.295 million Iranians living outside of Iran, or about 1.7% of the total Iranian population. Of those Iranians living abroad, 14.5% have tertiary level education and 8.4% are physicians that were trained in Iran (World Bank, 2011). Finally, the World Bank estimates that the diaspora is also responsible for \$1.329 billion in remittances to

Iran. Even then, Hakimzadeh reiterates that the international institutions omit informal transfers. She states, “more than half the total remittances to Iran were transmitted through a *hawala* system, an informal network of money dealers that offers faster and cheaper means of transfer than formal channels” (Hakimzadeh, 2006). Thus, there could be close to \$2 billion in remittances to Iran.

Given that the Iranian diaspora is well educated and well financed, it appears likely that if liberal market reforms take place following the end of the sanctions that the diaspora will invest heavily in the Iranian economy. Using Gillespie, Riddle, Sayre, and Sturges (1999) as a starting point, there are two reasons that would propel FDI by the Iranian diaspora — ethnic advantage and altruism. Expatriates are always in a good position to invest in their origin country as they have specific knowledge that non-native investors lack. Lowell and Gerova (2004) discuss how entrepreneurship is one of the most sought-after features of a diaspora community when a country seeks investment. They also discuss the importance of nostalgic trade, arguing that this is simply a first-order creation. They state, “The trade stimulating function that expatriates play includes that of leader/reputation builder, middleman, or enforcer” (Lowell & Gerova, 2004). Finally, the creation of transnational social networks within a diaspora community is one of the most important mechanisms for foreign direct investment (FDI) in the home country. Lucas (2005) notes that these networks can help overcome the information gap that often exists when foreign investors are seeking to enter a new market. This will be more pronounced in Iran, where less than 0.5% of Iranian stocks are foreign owned. Typically, foreign investors own anywhere from 20% to 30% of stock markets in an emerging economy. Ramin Rabii, the manager director of Turquoise Partners, an investment firm in Tehran, suggests it will take at least two years for international banks to reestablish their ties with domestic institutions, restricting large inward flows (Torchia, 2014). Thus, the diaspora will help Iran properly integrate into the global economy.

According to Bagheri and Nanehkaran (2013), “the most active sectors for investments with relative advantages are: information technology sector, petrochemicals, energy, water, agriculture (especially agricultural exports) and tourism sectors.” And Iran is ready to capitalize, seeking to attract \$900 billion in investment in their economic sectors (Press-TV, 2014). Investment will most likely occur in the oil sector, which is often the most lucrative. However, the Iranian government has recognized the importance of other sectors. For example, anticipating relaxed sanctions, Iranian authorities have begun investing heavily in Kish Island, an economic-free zone that the Iranian government thinks can rival Dubai as a tourist destination (*The Economist*, 2014). Still, when looking at the list, statist forces would have strong influence in all sectors. This is where the Iranian diaspora may have an advantage over non-Iranian investors. Even if some liberal market reforms take place in these sectors, it is highly unlikely that statist institutions will dissipate entirely, or even quickly. More than likely, existing structures

in these sectors will fight liberal market reforms, even in places like Kish Island. Yet, the influx of FDI that will come from the diaspora and the changes it will bring, will eventually weaken these structures and in the process bolster the reforms.

Having said this, the strong role of the state in monitoring activity within the business community, and by extension investment by foreign individuals would most certainly continue. Finally, the Iranian state itself is fractured. While many media pundits ascribe almost all political power within Iran to Ayatollah Khamenei, there exist different nodes of power within the Iranian government. These nodes are interdependent on each other and have varying degrees of autonomy and capacity, which change given the political climate. Given this, statist policies within Iran vary depending on the economic sector, and on occasion may conflict. Thus, members of the Iranian diaspora may find themselves part of the power struggles between different parts of the Iranian state.

Another obstacle includes the power of patrimonial elements such as the Basij. The Basij are paramilitary volunteer militias that formed after the Islamic revolution of 1979. Basij militia leaders have used their positions of societal influence to establish patron–client networks within Iran and build up their business clout (Golkar, 2012). The Basij have accomplished this through various instruments. This includes the intimidation of the traditional Bazaari business community in Tehran and through the management of large SOEs. Golkar (2012) notes that economic liberalization is a direct threat to the Basij and their power within the Iranian economy, and by extension Iranian politics. The patrimonial networks of the Basij will remain an important structure within the Iranian economy. Members of the Iranian diaspora who invest in the Iranian economy will need to recognize and understand their role.

Most of the FDI by the diaspora community will come from Iranians living in the United States and other Western countries, such as Canada. However, within the Middle East and South Asia, the United Arab Emirates is also set to benefit from any thaw in U.S.–Iran relations. The sizable Iranian expatriate community in the UAE is believed to be around 400,000 and is set to take advantage of the removal of the sanctions regime and any liberalization reforms that may accompany it (Shoamanesh, 2009). There are two factors that stand out when taking about the Iranian diaspora in the UAE. First is proximity; the UAE sits on the other side of the Persian Gulf, across from Iran. Dubai is less than 100 miles from Iran's southern shores. Second is the remarkable financial success of the Iranian community itself. There are historical links between Iran and the UAE as an Iranian merchant class has existed in Dubai since the 1800s. According to Sarmadi (2013), the local word for Emiratis of Iranian origin is *ajami*, and they are an important element in Dubai society. This familiarity with Iranian culture has made the UAE a top destination for the Iranian middle class, where Iranian artists come to vacation and Iranian businesses set up shop to skirt U.S. sanctions (Sarmadi, 2013).

## 5.5. Conclusion

This chapter strived to accomplish several objectives: understanding the political economy of Iran; and the future role of the Iranian diaspora in FDI. The 10-year analysis shows that Iran is a mostly patrimonial state that has become slightly less statist and more liberal. This liberalism can be seen in the 2005 reinterpretation of Article 44 in the Iranian constitution. Article 44 originally mandated that all major industries be owned and/or dominated by the national government. The new interpretation, signed off by Ayatollah Khamenei himself, would have ostensibly allowed the Iranian government to sell up to 80% of shares to nongovernmental entities, with the government retaining 20%. However, the patrimonial policies of the Ahmadinejad prevented privatization from taking place. He demanded that another 20% of shares be allocated as “justice shares,” which he argued should be controlled by the vulnerable classes in Iranian society. These shares would be controlled by new cooperatives, which in reality were fronts for Ahmadinejad’s clients (Khajehpour, 2013). Not surprisingly, the privatization process stalled, and only since Rouhani was elected have privatization and economic liberalization come back in vogue.

In sum, the Iranian diaspora is well positioned to help with the technology, capital, and know-how to revitalize Iranian economy as it liberalizes. The key asset of the diaspora is its integration within Western societies. This depth will allow expatriates to bridge the information gaps that will undoubtedly develop as FDI increases. The statist and patrimonial elements that still exist in Iran will require expert guidance that most foreign firms will find valuable. In addition, the Iranian government has intermittently reached out to the diaspora for investment, so the precedent exists for expatriates to help. For example in the 1992 economic crisis, then President Rafsanjani had hoped to circumvent the lack of access to foreign capital by courting Iranians living abroad. However, Kuhn (2014) notes that Rafsanjani was thwarted by conservative elements in Iranian society that feared the “capitalist diaspora” would undo the Iranian revolution. With Rouhani, there may finally be an administration that can help undo the statism and patrimonialism that have developed since the 1979 revolution.

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## **PART II**

# **NUCLEAR NEGOTIATIONS AND AFTERMATH**





## Chapter 6

# Economic Incentives and Pressure in Nuclear Negotiations with Iran

Eugene B. Kogan

### Abstract

Economic opportunities can be nimble tools of bargaining. When denied, they can be potent tools of coercion. When showcased they can serve as powerful incentives to reach agreement. If skillfully used to simultaneously pressure and entice, economic prospects can improve the chances of agreement within the respective negotiation teams in order for them to reach a deal across the table. This chapter critically analyzes the role of economic incentives and pressure in the nuclear negotiations between the international community and Iran. It discusses how an economic coercion and inducements campaign can help shape the internal consensus in Tehran in favor of a deal. In particular, a concerted effort to understand the opposing side's negotiation band — the environment of “behind the table” constraints that shape the resulting bargaining strategy — can increase the chances of success in negotiation. Understanding a negotiator's negotiation band requires a careful analysis of domestic political dynamics during the preparatory stage, active listening during negotiation, and outreach to deal advocates throughout the process to help them shift the domestic balance in favor of a deal.

**Keywords:** Negotiation band; nuclear; coercion; incentives; business

## 6.1. Introduction

Economic opportunities can be nimble tools of bargaining. When denied, they can be potent tools of coercion. When showcased they can serve as powerful incentives to reach agreement. If skillfully used to simultaneously pressure and entice, economic prospects can improve the chances of agreement *within* the respective negotiation teams in order for them to reach a deal across the table. This chapter critically analyzes the role of economic incentives and pressure in the nuclear negotiations between the international community and Iran.

Stopping Iran from coming dangerously close to a nuclear weapons capability is a key priority for the Obama Administration. “The goal of these negotiations,” states the Joint Plan of Action, signed by Iran and P5 + 1<sup>1</sup> in Geneva on November 24, 2013, “is to reach a mutually-agreed long-term comprehensive solution that would ensure that Iran’s nuclear programme will be exclusively peaceful. Iran reaffirms that under no circumstances will Iran ever seek or develop any nuclear weapons.”<sup>2</sup> The United States along with its allies has employed economic and financial coercion and cyber sabotage to raise the costs of Iran’s noncompliance with nonproliferation demands and to demonstrate that Tehran’s efforts to proceed with its nuclear weapons program will not succeed. Iran claims that its nuclear program is entirely civilian and peaceful and seeks to have the sanctions lifted (and sabotage to stop). “The question,” David Sanger of the *New York Times* has aptly observed, “is whether there is an acceptable middle ground that would allow Iran to declare that the West has acknowledged its right to enrich [uranium] and left it with a significant capability to do so, while still satisfying the rest of the world that Iran is not on the threshold of a capability to build an atomic weapon” (2014). The deal currently on the table involves a fundamental quid pro quo: the Iranian regime’s stability is assured, but, if a decision to go nuclear is taken, Tehran is left one year or longer away from becoming a nuclear power.

This chapter analyzes the interests, motivations, and constraints of the key Iranian decision-making factions. Building on Ambassador Nicholas Burns’s argument for playing “on the growing divisions within the Iranian elite” (2009), this chapter discusses how an economic coercion and inducements campaign can help shape the internal consensus in Tehran in favor of a deal. The chapter has six sections. The first section introduces coercive negotiations and discusses how they are different from traditional deal-making. The second section discusses Iran’s and United States’ respective interests in the nuclear talks. The third section analyzes the advantages of a nuclear deal for Iran. Sections four and five discuss the alternatives

<sup>1</sup>China, France, Russia, the United Kingdom, the United States, and Germany, in cooperation with the European Union.

<sup>2</sup>Joint Plan of Action, November 24, 2013 ([http://eeas.europa.eu/statements/docs/2013/131124\\_03\\_en.pdf](http://eeas.europa.eu/statements/docs/2013/131124_03_en.pdf)).

for Iran and the United States, respectively, of reaching a nuclear agreement. The concluding section discusses the broader lessons from nuclear negotiations for deal-making and its economic ramifications, especially with respect to how a nuclear deal can facilitate Iran's reintegration with the global economy through trade and commerce.

## 6.2. Coercive Negotiations

In negotiations, it is important to seek a sophisticated understanding of the other side's *negotiation band* — the political space within which the negotiators operate in crafting their bargaining strategy.<sup>3</sup> By seeking a more nuanced understanding of the opposite side's negotiation band, a negotiating party can craft a strategy that makes it easier for the other side to accept its demands. This is particularly important in coercive negotiations, such as nuclear talks, where trust is likely to be lacking and misconceptions, deepened by the forceful tactics on both sides, abound.

Coercive bargaining departs in some significant ways from the interests-based deal-making framework pioneered by Harvard Law School professor Roger Fisher and his colleagues in their book *Getting to Yes* (Fisher, Ury, & Patton, 1991). Negotiation enables the parties in a conflict or disagreement to identify and potentially increase mutual gains. By thinking creatively about how they can work together, the parties can learn how to collaborate instead of being stalemated in their own respective positions. For example, *Getting to Yes* is well-known for the story of the two sisters who argue over one orange. When each sister ended up with a half of the orange, one girl ate the fruit and threw out the peel, while the other jettisoned the fruit and used the peel as an ingredient for a cake. The moral of the story is clear. Had the two sisters talked about why they wanted the orange in the first place, they would have realized that their interests did not compete, but, in fact, complemented one another's. One of them could have gotten to eat the whole fruit, while the other would have had more peel for the cake — a “win-win” outcome.

As in the preceding deal-making example, coercive bargaining involves a reconciliation of conflicting interests between parties. One key difference between coercive and traditional negotiation, however, is that in coercive bargaining parties do not come to the bargaining table at their own volition as the sisters did in the above example. After all, despite failing to “maximize value” — that is, they did not divide the orange in the most efficient way possible to maximize enjoyment for each girl — they both wanted to negotiate the division of the orange.

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<sup>3</sup>The term “negotiation band” originates in my conversation with Professor Alain Lempereur of Brandeis University in December 2014.

In coercive bargaining, however, party A, which is unhappy with the status quo, forces party B to come to the negotiating table in order to persuade party B to accept a change to the status quo. In nuclear negotiations, for example, the United States is troubled by the fact that Iran has a covert nuclear program, and possibly a concealed nuclear weapons program and has forced Iran to negotiate in order for Tehran to allay the suspicions (in Washington and around the world) that the Islamic Republic is seeking to acquire the capability to build a nuclear bomb under the cover of a civilian nuclear program. Another important difference is that coercive negotiation is more likely to be characterized by the use of aggressive tactics.

In international disputes, coercive bargaining, which occupies the middle ground between diplomacy and war, involves the efforts by one state to change the behavior of another through military or economic threats and sanctions, as well as targeted/limited uses of military force and cyber capabilities. In negotiations with Iran, military force is “on the table” (albeit as a last resort), and military means have been used to sabotage the nuclear program through the assassinations of Iranian nuclear scientists. The United States and its allies also imposed economic sanctions on Iran. Such forceful negotiation tactics are attractive tools of statecraft because they hold out the promise of achieving tough geopolitical objectives — ones that purely diplomatic means are unable to attain — without having to resort to full-scale military hostilities. In *The Art of War*, Sun Tzu’s observation serves a pithy summary of coercive negotiations: “To subdue the enemy without fighting is the acme of skill.”

Coercion is an important tool of statecraft because it allows a state to achieve its objectives “on the cheap” — without resorting to war. Nobel Prize winner Thomas Schelling has written that coercion works if punishment for miscreants is contingent on their behavior. The threat “one more step and I shoot,” Schelling wrote, would only be effective if one added, “And if you stop I won’t (1966, p. 74).” Reassurance inherent in this statement is critical for coercion to work. The speaker threatens devastating consequences for noncompliance, yet promises to lift the threat if the target does as he is told. “To be coercive, violence has to be anticipated,” Schelling explained, “And it has to be avoidable by accommodation” (1966, p. 2).

History provides useful illustrations. President Kennedy quarantined Cuba in October 1962, and threatened Moscow with war if the Soviets did not withdraw their nuclear missiles from the island. The Cuban Missile Crisis ended once the Soviets agreed to comply — and, as is now well-known, after Washington secretly agreed to withdraw its Jupiter missiles from Turkey, as well as promised not to invade Cuba to try to remove Fidel Castro from power. This was a coercive success, but one that involved a *quid pro quo*.

In negotiations over weapons of mass destruction, *quid pro quos* are particularly important. No rational actor can be expected to give up the quest for a nuclear deterrent capability if there is a possibility that in doing so he would be increasing the possibility of becoming a target for regime change. This fundamental idea was seriously damaged by the Libyan example. In 2003 Muammar Qaddafi gave up his

nascent nuclear weapons program and for several years basked in international limelight, including by giving lengthy diatribes at the United Nations. Yet, in 2011, a NATO military coalition enabled the domestic rebellion to overthrow (and eventually kill) the Libyan dictator.

This created a damaging perception: if you give up weapons of mass destruction — in particular, nuclear weapons or, at least, a nuclear weapons program — the United States just might decide to violate its promises and overthrow you as punishment for nonnuclear “bad behavior” (e.g., massive violations of human rights). Those who make this argument point to Iraq (no nuclear deterrent — Saddam Hussein overthrown) and North Korea (a nuclear deterrent — Kim Jong Un succeeded his father Kim Jong II with no end in sight for the Kim dynasty). Both countries have engaged in horrific human rights abuses; the only factor that appears to account for their wildly different fates was that one of them had nuclear weapons to keep the superpower at bay, and the other did not.

In nuclear negotiations between Iran and P5 + 1, this perception is a key part of Iranian delegation’s negotiation band because in order to reach the nuclear deal with the West they have to overcome this narrative back in Tehran. Iranian hardliners — deal skeptics<sup>4</sup> whose opposition must be overcome if a deal is to happen — are likely haunted by the Libya example as they justify their opposition to the deal by claiming that the United States aims to overthrow their regime (Sanger, 2014). To achieve the deal with Iran, the United States needs to widen the deal advocates’ negotiation band enabling them to win the internal debate in favor of the deal. This chapter discusses how a strategic use of business incentives can serve this purpose.

### **6.3. Iran’s and U.S. Interests**

Regime survival and internal stability are the principal interests that all factions in Iran — the clerics, the Supreme Leader Ali Khamenei, the Revolutionary Guards, and President Hassan Rouhani — share. The Revolutionary Guards can be expected to want to assure this objective through the building of a nuclear weapon or, at least, acquisition of a nuclear weapon capability — possession of the requisite component parts, fissile material, and technology to enable the production of a nuclear weapon. Some within the Revolutionary Guards likely want to achieve a “breakout capacity” — the ability to build a weapon within months if not weeks. The second widely shared objective is regional political, diplomatic, scientific, and economic influence, starting with the lifting of sanctions that have halved Iran’s oil revenue, weakened its currency, and cut Iran off of the international banking system (Sanger & Gordon, 2014).

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<sup>4</sup>I borrow this term from Sebenius (2014).

The key objective of the United States is to prevent Iran from acquiring a deployable nuclear weapon. In particular, Washington wants to keep Iran as far as possible — at least a year away — from achieving a nuclear weapons capability. Likewise, the United States wants to preclude Saudi Arabia from going nuclear (likely by acquiring nuclear weapons from Pakistan), which Riyadh has warned it would do if Iran acquires nuclear weapons. Washington also aims to strengthen the nuclear nonproliferation regime by finding a negotiated solution to the spread of nuclear weapons. Finally, the United States wants to contain Iranian influence in the region — specifically, its support for terrorist groups such as Hezbollah.

Since 2012, the United States has been actively using economic and financial sanctions as punishment to force Iran to make concessions. The Iranian economy's heavy dependence on oil and gas revenues made these industries natural targets for nonproliferation sanctions. In 2008–2009, oil exports accounted for as much as 65% of government revenues. That figure has now dropped to 50% (Faucon & Spindle, 2014; Mohamedi, 2010). With declining oil prices, this figure is likely to decrease even further.

The decline of oil prices has placed unprecedented, and unanticipated, fiscal pressure on the Iranian economy. Relentless oil production by OPEC members (particularly, by Saudi Arabia that is eager to put pressure on Iran's economy to force its capitulation in the nuclear talks) has created oil oversupply causing the price of crude to decline from \$101.33 to \$48.66 per barrel in the past year. This drastic drop, coupled with Iran's already limited production capabilities, will seriously impact a state whose 2015 budget relied on a \$72 per barrel price projection. If Iran were to have the financing to develop and extract its oil reserves, it may have the ability to become more independent and influential among OPEC members and have the ability to help set prices via production.

P5+1 have also used economic prospects as incentives, as evidenced by the “limited, targeted, and reversible sanctions relief,”<sup>5</sup> implemented from January 20, 2014 to July 20, 2014, and renewed for six months on July 19, 2014 and again on November 24, 2014. The easing of sanctions allowed Iran to increase oil exports to China, but still kept production (roughly 1 million barrels per day (bpd)) below the pre-2012 level (2.2 million bpd in 2011) (Verma & Aizhu, 2014).

This phrasing — “limited, targeted, and reversible sanctions relief” — encapsulates the coercive negotiation dynamics between the United States and Iran. The term “relief” emphasizes the promise of the future relationship Iran can enjoy once, having satisfied the P5+1 nonproliferation demands, it is allowed to reintegrate in the international economic system. The qualifying adjectives — “limited, targeted,

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<sup>5</sup>“Guidance relating to the provision of certain temporary sanctions relief in order to implement the Joint Plan of Action reached on November 24, 2013, between the P5+1 and the Islamic Republic of Iran, as extended through June 30, 2015” ([http://www.treasury.gov/resource-center/sanctions/Programs/Documents/guidance\\_ext\\_11252004.pdf](http://www.treasury.gov/resource-center/sanctions/Programs/Documents/guidance_ext_11252004.pdf)).

and reversible” — remind Iran of the punishment that will continue to be imposed upon it — and, likely, increased — if a deal is not reached. As Ambassador Nicholas Burns reminds us, “We should constantly remind our adversaries that we have other options, including the possible use of force, if talks fail” (2008).

## **6.4. Iran: Advantages of a Deal**

### ***6.4.1. “Narrow” Deal/No Regime Change***

The deal would focus narrowly on the Iranian nuclear activities in order to either curtail them or to monitor them to make secret “breakout” impossible without detection and reimposition of punishment. The deal would thus leave aside Tehran’s support for terrorism, Hezbollah, and related issues. On the Iranian side, this will strengthen the hand of President Hassan Rouhani and deal advocates to argue for acceptance of the bargain. The United States, they will be able to argue, is not interested in regime change — as might have been evidenced by its demand for a wholesale change of Iran’s foreign activities. The proposed deal would preserve Iran’s regional influence despite depriving Tehran of the ability to acquire nuclear weapons. And the lifting of sanctions would enhance Iran’s economic clout in the region and internationally.

### ***6.4.2. Lifting of Sanctions***

The nuclear deal between P5+1 and Iran, if agreed to, would lead to the lifting of economic sanctions, currently in place against Iran, releasing the \$100 billion in frozen oil revenue (Faucon & Spindle, 2014). Iran, which has the world’s fourth largest proven oil reserves (Rezaian, 2013), requires foreign investment in order to develop, expand, and refurbish its oil fields and refineries. For example, in 2006, the National Iranian Oil Refining and Distribution Company (NIORDC) made public plans for a \$16 billion initiative to upgrade its refineries in order to increase its refining capacity twofold to 3.3 million bpd (Mohamed, 2010). Projects like this have been stymied by sanctions.

Iran is also home to the world’s second largest natural gas reserves,<sup>6</sup> and it needs financing for the development of South Pars gas field — the world’s largest (Mohamed, 2010). Iran’s inability to finance production and exploration initiatives is a weakness that will only grow worse as the country’s domestic energy consumption rises — one of the key needs Iran cites in justifying its uranium enrichment. By offering a solution that would solve Iran’s energy supply shortage and diversify its

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<sup>6</sup>“Country Analysis Brief: Iran,” U.S. Energy Information Administration, July 21, 2014 (<http://www.eia.gov/countries/analysisbriefs/Iran/iran.pdf>).



revenue streams, the United States would undermine Iran's rationale for uranium enrichment.

One way the United States can signal its support for the economic opening is by sending a high-level representative to the upcoming Tehran's Chamber of Commerce conference (Erdbrink, 2014). Iran craves Western respect, and U.S. representation by a senior envoy, while risking little, would signal that Washington is ready for business with Iran. This would be a message to the Iranian hardliners that the United States is ready for a fresh start in bilateral relations if Iran cooperates. Attending a business conference could have an additional advantage of presenting an opportunity for a direct, low-key bilateral contact with the Iranian side. Personal relationships can help lubricate the coercive bargaining process, and often prove critical for effective deal-making (see, e.g., Burns, 2014). In fact, this could be an opportune moment to propose establishing a regular, direct, and secret communication channel between Washington and Tehran. But if Iran does not stop its progress toward a nuclear weapons capability, then unyielding pressure and sanctions will continue and, likely, increase. As the Harvard Law School negotiation expert Robert Mnookin suggests: "The perception that you have the will (and the capacity) to resist can often influence the other side's perception of their risks — should they refuse to negotiate" (Mnookin, 2010).

#### 6.4.3. Participation in "Big Science" Projects

Washington also should support Rouhani's efforts to decouple Iranian pride from the nuclear pursuit. If Iran accepts the deal, it should be given an opportunity to participate meaningfully in the Large Hadron Collider, managed by the European Organization for Nuclear Research (CERN).<sup>7</sup> This will likely be tempting for Iranian nuclear scientists who will get a tangible and highly prestigious substitute for the current thrust of their research. Instead of pursuing a patriotic national project, they will be involved in an internationally recognized "big science" project that will provide them with a range of professional opportunities beyond the ones that they are currently able to enjoy.<sup>8</sup> The deal advocates will also be able to point out that participation in such a project will give Iran the regional and international exposure and status it seeks in the scientific field. After all, President Rouhani stated recently: "Our ideals are not linked to centrifuges but to our heart and determination" (Nasseri, 2015). The advantage of this proposal is that it has the potential to

<sup>7</sup>This point is based on my discussion with Professor Matthew Bunn at Harvard Kennedy School, December 2013.

<sup>8</sup>The Cooperative Threat Reduction (CTR) program, named after former U.S. Senators Sam Nunn and Richard Lugar, is an excellent example to follow. The CTR has helped reorient the research trajectories of thousands of former Soviet nuclear scientists away from weapons activities to peaceful nuclear research.

undermine the ranks of deal skeptics by persuading at least some of them that there are ways to enhance Iran's prestige without pursuing a nuclear weapons program.<sup>9</sup>

#### **6.4.4. Credibility of the “Value-Enhancing”<sup>10</sup> Options**

The actual effectiveness of the incentives discussed above will depend on whether the Iranian skeptics and the deal advocates will see them as credibly forthcoming if Iran accepts the deal. If seen as credible, these options can be effective tools of persuasion used by deal advocates. The less credible they look, the less ammunition the deal advocates within Iran will have to utilize in persuading the skeptics to back the deal.

Credibility is traditionally seen as a function of capability and magnitude. *Capability* involves the U.S. ability to deliver on its promises, including by being willing to incur the transaction costs such as the reactions by deal skeptics within its domestic and global coalition. To demonstrate capability, the United States should set up a high-level commission on U.S.–Iranian economic engagement to start putting together concrete plans to deliver on the promised incentives. By laying out specific steps that the United States and the international community will take to integrate Iran into the global economy, the United States would be demonstrating a seriousness of purpose, signaling that these proposals are not just “cheap talk,” but that Washington is prepared to act on its promises. This would, in fact, be in the U.S. interest since Iran's economic opening would create business opportunities for U.S. companies who are eager to get access to the middle-class, young (60% under the age of 30), and educated Iranian consumers.<sup>11</sup>

The commission should discuss how U.S. commitments can be implemented. For example, one possibility is to make clear that Washington can use executive instruments — instead of relying on congressional action, which is vulnerable to stalemate tactics by hardliners irrevocably opposed to any deal with Tehran — to carry out its part of the bargain by lifting the sanctions. Such concrete discussion will enable the deal advocates within Iran to make a stronger case to deal skeptics that the U.S. offers are, in fact, credible in that the Obama Administration has the tools to carry it out. Likewise, when discussing “big science” projects, the commission needs to be specific in the types of opportunities the Iranian scientists will have and the roles they will be allowed to play within the CERN. The more specificity the commission

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<sup>9</sup>The U.S. experience in coercing Taiwan during the Cold War to abandon its nuclear pursuit is a good example to follow. In that case, Washington deployed teams of scientists and diplomats to Taipei to persuade the scientists there not to engage in prohibited activities. The Ford and Carter Administrations sought to make sure that their nonproliferation message gets through to the rank-and-file, and not only to the top decision-making echelons.

<sup>10</sup>I borrow this term from *Sebenius (2014)*.

<sup>11</sup>“Iran Overview,” World Bank, September 30, 2014 (<http://www.worldbank.org/en/country/iran/overview.print>).

can bring to the discussion, the stronger the case the deal advocates will be able to make to the scientists that they ought to abandon the nuclear project.

*Magnitude* speaks to whether the incentives offered actually address the fundamental interests of the Iranian side. Offering an assurance that the United States does not seek regime change directly responds to the key Iranian concern of regime stability. All factions in Tehran will need some indication that this assurance is irreversible. The strongest such indication can come in the form of a public Presidential commitment. Breaking public commitments — as President Obama’s recent experience with the “red line” on chemical weapons use in Syria illustrates — will carry significant political costs both domestically and internationally. While reneging on public commitments thus cannot be ruled out, it is certainly more costly than denying that a private assurance was made.

## 6.5. Iran’s BATNA<sup>12</sup>

The deal will not allow Iran to satisfy all of its objectives. Iran will give up for the foreseeable future the ability to quickly make a nuclear weapon, and thus forfeit the most effective and trusted way to guarantee regime survival. Instead, it will have to rely on political guarantees for regime security. Tehran understands that “political guarantees” is an oxymoron since they never represent inviolable promises on which a state can rely for security. As political scientist Avery Goldstein puts it, “On practical strategic and normative political grounds, states prefer autonomy to dependence and search for ways to provide for their own security” (Goldstein, 2000, p. 257). The only genuinely reliable security guarantee would come from an independent nuclear deterrent that Tehran itself controls.

Iran can reject the deal and pursue the alternative: the pursuit of a better deal that leaves it closer to “breakout” nuclear weapons capability. The deal advocates in Iran should stress to the deal skeptics that the costs of this option are substantially greater than the disadvantages of the proposed deal. The first cost is the high likelihood of an Israeli military strike to prevent the Iranian program from remaining within months of a nuclear weapon (see, e.g., Raas & Long, 2007). The deal skeptics can be expected to counter that the United States will seek to restrain Israel from taking such a step, but, of course, they cannot be sure for how long Washington will succeed in counseling such restraint. In the absence of a nuclear deal, most in Iran likely understand that Israel will take military action to temporarily set back the Iranian program. Furthermore, if the United States joins the effort, the military campaign may well expand into an effort to change the regime. Bottom line: while the deal on the table is not optimal, the “no-deal” alternative is worse as it increases the chances of Israeli military action and regime change.

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<sup>12</sup>Best Alternative to a Negotiated Agreement.

The second cost of a “no-deal” option is that opponents of negotiations with Iran will push for sanctions, already crippling the Iranian economy, to be stiffened. The United States will be in a strong position to persuade Russia and China to strongly back these measures against a recalcitrant regime that has rejected all the overtures by the international community. The key argument: under the deal, the lifting of the sanctions may be reversible, but the alternative is worse since sanctions will remain in place indefinitely and will be strengthened. The third cost of rejecting a deal is that Iran would be giving up on attractive value-enhancing options that the agreement would bring. Furthermore, in addition to missing out on the opportunities to participate in “big science” projects, the Iranian nuclear scientists will remain targets for assassination. As Harvard Business School negotiation expert James Sebenius points out, “even if credible, one party’s disinterest in incentives at an *earlier* stage of negotiations need *not* mean its *later* disinterest in the very same incentives if that party’s no-deal options have been badly degraded in the interim” (Sebenius, 2014, p. 5, emphasis in original). In sum, while the deal will not satisfy all of Iran’s objectives, the agreement advocates should argue that it serves Iran’s fundamental interests better than the pursuit of the no-deal alternative.

## 6.6. U.S. BATNA

Like Iran, the United States does not achieve all of its objectives with this approach, which leaves unaffected Iran’s support for terrorism and likely would enhance Tehran’s regional and global economic clout. Furthermore, despite the fact that Iran will be seen as having given in to pressure, U.S. allies in the region — in particular, Israel and Saudi Arabia — will be disappointed and concerned that Iran’s nuclear capabilities were not degraded more extensively, leaving it further away from a potential nuclear weapons capability. Saudi Arabia may continue making pronouncements about the failure of American leadership, and, relatedly, about its desire to acquire nuclear weapons.

The United States can reject the deal and pursue the alternatives: a full-fledged military effort to reverse the Iranian nuclear capability, or the imposition of further sanctions to force Iran to dismantle more of its existing nuclear infrastructure. These options are problematic for several reasons. First, a complete (Libya-style) reversal of the Iranian nuclear program is virtually impossible. Even a concerted, U.S.–Israeli military campaign to degrade Iranian nuclear facilities is likely to only temporarily set back Tehran’s nuclear work and will inflame Iran’s desire to go nuclear despite the pressure. The rally-around-the-flag effect is likely to be evident with the population strongly backing the atomic pursuit. Second, further sanctions, while holding the promise of breaking Iran’s resolve, may help the hardliners to decisively win the domestic debate in favor of continued nuclear work thus sidelining any domestic opposition. In sum, as Harvard Kennedy School Professor

Graham Allison forcefully argues: “What is worse than the current Iranian regime with all of its attributes and actions we hate? My answer is: that same regime with nuclear weapons.” “An ugly deal,” he continues, “that achieves our minimum essential objectives is better than the other feasible alternatives — namely an Iran advancing ever closer to a bomb, or another war in the Middle East” (Allison, 2014).

## 6.7. Conclusion

Decreasing oil prices are magnifying the effects of sanctions on the Iranian economy.<sup>13</sup> Tehran is therefore more vulnerable than ever to economic coercion and incentives. According to the U.S. Department of State, the nations negotiating with Iran “have made clear that Iran’s full compliance with its international nuclear obligations would open the door to its receiving treatment as a normal nonnuclear-weapon state under the Nonproliferation Treaty and sanctions being lifted.”<sup>14</sup>

It is quite clear that the lifting of sanctions and normalization of trading relationship will allow the much needed foreign investment to flow into Iranian oil and gas sectors. The Iranian state oil company can also import parts and equipment needed for maintenance and upgrade of its existing pipelines, refineries, and other oil and gas related facilities. In the wake of current sanctions on Russia by the United States and EU countries, Iran may emerge as a major exporter of oil and gas to Europe, which has been dangerously reliant on Russia for its energy needs. Lifting of sanctions will also allow Iran to complete the now stalled Iran–Pakistan–India gas pipeline, which will help both Iran and energy-hungry Pakistan and India. Normalization of trading relationship should also help Iran develop its non-oil export sectors such as carpets, agricultural produce, and tourism, just to name a few. Given its large domestic market, the Iranian automotive, banking, and telecommunication industry should also develop quickly if the sanctions are lifted.

This chapter does not argue that a strategic use of economic coercion and inducements would guarantee the acceptance of the nuclear deal — only that such a campaign would make a deal more likely. By making clear the economic incentives that Iran will get as a result of a nuclear deal, Washington would be building leverage with Iran implicitly threatening to take these offers away at a later time if Iran refuses to accommodate the international community’s demands.

This chapter thus sets out the broad parameters of a negotiation process that can be applied to the negotiation of any deal. In particular, a concerted effort to understand the opposing side’s negotiation band — the environment of “behind the table” constraints that shape the resulting bargaining strategy — can increase the chances of success in negotiation. Understanding a negotiator’s negotiation band requires a

<sup>13</sup>Professor Meghan O’Sullivan presciently wrote about this in 2012. See O’Sullivan (2012).

<sup>14</sup>“Iran Sanctions,” U.S. Department of State (<http://www.state.gov/e/eb/tfs/spi/iran/index.htm>).

careful analysis of domestic political dynamics during the preparatory stage, active listening during negotiation, and outreach to deal advocates throughout the process to help them shift the domestic balance in favor of a deal.

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## Chapter 7

# Iran and the West: A Nuclear Settlement and Its Aftermath

Farid Mirbagheri

### Abstract

The tumultuous relations between the Islamic Republic of Iran and the West, in particular the United States, since the 1979 revolution is climaxing in the dispute over Iran's nuclear development. However, if as expected, a settlement is reached, mainly by Iran backing down, an important question would loom on the horizon: Can the West, and principally Washington, live happily and peacefully with a theocracy that is ideologically radical in character and anti-American in orientation? This essay deals with that question and explores pathways that may lead to some answers. In so doing it will point out the root causes of the hostility of the clerical establishment towards the United States and why despite various attempts and strong incentives a thaw in relations has eluded both capitals. Significant internal and external factors will be highlighted in this regard and how they may perceivably give (or not give) way to the resumption of diplomatic ties between Iran and the United States will be investigated.

**Keywords:** Nuclear agreement; rapprochement; revolutionary; competition; oil and gas; theocracy



## 7.1. Introduction

Speculation on the outcome of the ongoing nuclear negotiations between the Iranian government and the Five plus One brings into focus discussion on the state of relations between Tehran and West in the event a comprehensive or even temporary agreement. Many are of the opinion that the theocratic government has no alternative but to acquiesce to Western demands. The UN-authorised biting sanctions have severely depressed Iranian economy and could be pushing it to the tipping point — total bankruptcy. The very survival of the regime, therefore, may now be contingent upon the removal of sanctions, itself linked directly to a nuclear settlement. The conclusion is clear: Tehran is bound to agree to the conditions set by the international community albeit wrapped in a packaging that would be less embarrassing for the Islamic Republic.

That, however, means the clerical establishment will have to have a face-saving formula in order to be able to justify its monumental retreat on the nuclear issue to Iranian people particularly its own supporters. Having spent around 200 billion dollars on the project, not to mention the cost of sanctions to the economy, all on the much-publicised premise that ‘nuclear development is our inalienable right’, the establishment is now very wary of a U-turn with the potential risks of dissent at home, even amongst its own rank and file. The ‘chalice-drinking’ of Ayatollah Khomeini some quarter of a century ago on accepting a UN-brokered ceasefire with Iraq cannot be readily repeated. The recent call by President Rohani for a referendum on the issue may just provide the escape route the regime needs. After all if it is what the people want, the regime will follow, they will argue.

Be that as it may, what then? What will become of the strained relations between Tehran and the West? Will Iran and the United States in particular restore diplomatic ties and will the Iranian oil and gas fields be open to US companies’ bidding once again? Will the Iranian market open up to US goods and services? Considering Iran is the world’s second richest country in terms of natural resources after Russia, stakes could hardly be larger. Can a country run by theocracy enter into conventional and stable relations with liberal democracies it has viewed as enemies for the past 36 years? Will the clerical rulers in Tehran shelve their animosity towards Washington and open a new chapter in their dealings with the United States? To answer these questions one will have to look into the deeper roots of tension and hostility that has bedevilled relations between Iran and the West in general and the United States in particular.

## 7.2. Anti-Westernism in Iranian Revolution

The downfall of the Pahlavi dynasty in 1979 and the subsequent establishment of the Islamic Republic in Iran heralded an era of aggressive foreign policy towards

Western countries but most notably the United States. Whilst the hostage-taking of US diplomats in Tehran for 444 days in the early days of the revolution offered a degree of assurance that Washington would not support any military coup against the fledgling regime (or else the hostages would have been killed)<sup>1</sup> the after-effects of that crisis have consistently caused tension and mistrust between the two capitals. Several attempts (at least three reported) have been made by politicians on both sides to mend fences but to no avail. First was the secret visit by McFarlane, advisor to President Reagan, bearing gifts for Iranian leaders in the earlier part of the revolution. Press leakage foiled that attempt and the man responsible for the leakage was subsequently executed in Iran (Gwertzman, 1987). Then in 1995 was the contract between the former President Rafsanjani's government and the US oil company Conoco signed to the value of 1 billion dollars. A presidential decree by President Clinton cancelled the deal. In response Rafsanjani stated that the United States did not understand and respond in kind to the signals that Iran was sending (Scilino, 1995). The last reported attempt to thaw relations was in 2003 in the aftermath of US overthrowing Saddam Hussein through the military occupation of the country. Iranian leaders, fearful of the same fate for themselves as Saddam, unilaterally suspended all nuclear activities and offered a comprehensive deal to the Bush administration to resume full diplomatic ties. The deal included a change of Iran's policy vis-à-vis Israel plus other important concessions. In return Tehran sought cast-iron guarantees that the United States will desist from any activity that may threaten the survival of the Islamic Republic in Iran. However, the offer was rejected by Washington and the messenger, a Swiss diplomat in Iran, was later reprimanded for delivering the message (Dinmore, n.d.).

The UK embassy too suffered banditry in Tehran in 2011 and has since closed its embassy in the country. Canada also severed its diplomatic ties with Iran in 2012. Iran is consistently condemned in the UN General Assembly as well as various Western fora for its violation of human rights. In short, relations between Iran and the West, have been strained at best and in some instances non-existent. Can a nuclear deal change that?

### **7.3. The Economic Imperative**

The Iranian economy has been experiencing a steady decline in the lifetime of the revolution thus far. The value of the Iranian currency has plummeted by a

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<sup>1</sup>Abbas Abdi, one of the hostage takers, stated at a meeting at UNESCO in Paris in June 1999 that the hostage-taking was a spontaneous act carried out by students and was expected to last a very short time. Though the latter part of his claim may be plausible all other indications point to a planned course of action to take over the US embassy in Tehran. Recent revelations in fact suggest that the former President Ahmadi Nejad objected to the hostage-taking but was overruled.

staggering 50,000% (500 times) against other currencies. Inflation has increasingly eaten into the purchasing power of the Iranian consumer and despite a near-complete lack of investment interest rates of around 20% further discourage investment. Corruption at all levels makes daily headlines and judicial process are in the main either non-existent or selectively applied. However, what actually are pushing the economy towards complete failure are the sanctions imposed on Iran by the UN Security Council for its nuclear policies. The Islamic Republic needs to get out of this.

The crucial aspect in the UN-imposed sanctions is the debilitating impact they have had on Iran's oil exports. From nearly 1.9 million barrels a day in 2012 Iran's export level has now fallen to below 1 million. Together with the decreasing oil prices, now less than half of what they were a year ago, they add significantly to financial pressure, whose burden falls mainly on the shoulders of an already disillusioned and discontented population. But it also hinders the expensive foreign policies the Iranian leaders are following in Iraq, Syria and Lebanon. The Iranian government simply cannot endure this crisis in the long or even medium term. Unofficial estimates give between one and two years before the collapse of the economy unless of course there are changes on the way.

Added to the malaise is an aging and long-neglected oil industry that is in desperate need of investment if Iran's current capacity in oil production is to be maintained. Thirty-six years of disregard for maintenance is now threatening to seriously disrupt the major source of income for Iran. There is now a hatch-patch of activities by the Iranians to attract the required investment (a minimum of 40 billion dollars but much higher figures have also been mentioned) to ensure current levels of production. Even though Iran is offering incredible terms to oil companies they are yet to secure any potential investor. International sanctions are standing in the way.

#### **7.4. Post-Nuclear Settlement**

The above clearly indicates that the dire economic situation has left the Islamic Republic with no option but to acquiesce to the demands of the international community on its nuclear development; at least for the short and medium terms. That, however, is unlikely to change their belief that nuclear military power is the only guarantee that they will never be forced out of power by external force — just as North Korea has not been but Milosevic, the Taliban and Saddam Hussein were. In all likelihood they will succumb to the demands to avert the immediate danger of economic and political collapse; but that would not in itself guarantee that in some unspecified future date they will not wish to pick up where they left off. After all, though nuclear development can be halted and nuclear infrastructure destroyed, the knowledge that develops them cannot.

Accordingly, the Five plus One will be wary of this particular aspect of an agreement: its durability into the future, which would require constant and intrusive verification by the International Atomic Energy Agency. That would seriously trouble the revolutionary regime though, who may feel its military secrets and capabilities can also be exposed in the process. In the absence of any viable air or naval force, the Islamic Republic has become heavily dependent on a largely indigenous missile system capable of targeting distant land including Israel (see Bahgat, 2007, p. 8). They would thus guard the location and other details of their missile sites fastidiously and probably not allow IAEA inspectors access to them. The picture could get murkier and far more complicated if one were to believe reports that Iran already has a couple of nuclear warheads in a state of readiness.<sup>2</sup> Lack of access to all the suspected sites therefore would certainly pose a problem with the potential to scupper any agreement.<sup>3</sup>

As for foreign policy goals there is a great deal of convergence that can bring Tehran and Washington together. They range from containing Sunni extremism including ISIL to providing stability in Iraq, Syria and Afghanistan. In fact a brief glance at the modern history clearly reveals the overlapping fields of foreign policy objectives between the two countries. In the immediate aftermath of WW II, when the occupying Soviet troops refused to leave Iranian territory and instead set up a puppet government in the northern part of the country, the staunch support of US President Harry Truman for Iran's territorial integrity and his stern warning to Joseph Stalin over the issue was an important factor in driving them out of Iran. In the post-revolution Iran, Washington and Tehran concurred on the use of armed force against Slobodan Milosevic. More importantly still, Iran's two enemies to the East and the West, the Taliban in Afghanistan and Saddam Hussein in Iraq, were both destroyed by the United States providing Iran with ample room to manoeuvre particularly in Iraq.

There is also very little that divides the people of the two countries. In fact despite the greater distance from home, the largest part of Iranian Diaspora live in the United States numbering between 1 and 2 million. During the days of the Constitutional Revolution, 1906–1909, an American named Howard Conklin Baskerville fought on the side of freedom fighters against the Qajar despotic King, Mohammad Alishah, and gave his life for that cause. He is regarded as a martyr and is buried in the city of Tabriz, where he was killed.<sup>4</sup>

The above would indicate that the path to the resumption of ties and amicable relations between the two capitals should not be too difficult to tread. Considering other external powers with a long and less than honourable history of intervention

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<sup>2</sup>Israel and Iran: Still no war in sight. *Defense and Foreign Strategic Policy*, 40(3), 8–10, 2012.

<sup>3</sup>Already there is a dispute between the Iranian government and the IAEA over the latter's wanting to visit *Parchin* site in Iran but the former refusing access to the site.

<sup>4</sup>A sculpture of Howard Baskerville is today located in the Tabriz constitution House as a martyr.

in Iranian affairs, chiefly Russia and the United Kingdom, the US record compares rather well. Other than its complicity in the 1953 coup against the populist Prime Minister Mosaddeq there is no other tangible instance of Washington meddling inside Iran. Should we therefore expect a speedy resumption of ties soon after an agreement on the nuclear issue is reached? Perhaps not. The continued hostility of the Islamic Republic to the United States almost since its establishment in 1979 indicates otherwise.

Thirty-six years on the chants of 'death to America' can still be heard in the rows of Friday prayers in Iran. The US flag, the symbol of American nation, is still burned on revolutionary occasions, which is an affront to the people of America. Of course they are all orchestrated by official or semi-official organs but why is the establishment in the Islamic Republic so vehemently anti-American? When Vietnam and the United States can make up and restore relations why can the clerics in Iran not do the same? What possible gains do they drive from their irrational and incessant hostility to Washington?

The promises made by the Islamic Republic to the Iranian people do not seem to have been fulfilled. The economy is in dire straits, unemployment has rocketed, inflation is above 30%, corruption is rife, drug addiction abounds, crime rate is high and Iranian prestige has plummeted internationally compared to the pre-revolutionary days. In consequence a large part of the Iranian society does not even feel as committed to their faith as before. In short, it may be argued that the *raison d'être* of the Islamic Republic is now under a big question mark. (It started in a big way when the Revolutionary leader, Ayatollah Khomeini, forfeited the cause of defeating Saddam — who had started the war — in the eight-year war with Iraq and, though more bitter to him than poison, accepted a cessation of hostilities with Saddam in power.) What possible claims to legitimacy therefore can the leaders of the Islamic Republic now lay before the Iranian people? On all fronts they seem to have faltered. The only possible exception is their anti-American rhetoric. It is the very last 'revolutionary premise' that may offer a degree of legitimacy to them amongst their supporters.

Parallel to that there may also be external factors that work against any rapprochement between Iran and the United States. Iran is rich in energy resources (arguably the richest in the world in terms of oil and gas combined)<sup>5</sup> and keeping the United States out of Iranian oil and gas fields obviously gives an advantage to US competitors, mainly Europeans. With a population exceeding 70 million Iran is also an attractive market for foreign exports. Strategically, Iran enjoys an advantageous position overlooking the Persian Gulf and the Straits of Hormoz, through which much oil is exported from the Middle East to the world. Needless to say, therefore, keeping the United States and Iran at loggerheads would politically and

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<sup>5</sup>See <http://www.thecountriesof.com/top-10-countries-with-most-natural-resources-in-the-world/>. Accessed on January 21, 2015.

economically benefit other major powers in the global arena. The Islamic Republic has also posed a significant challenge to the hegemony of the United States in the Middle East; something other world players would not wish to wither away.

## **7.5. The United States**

Overall, the US interests in Iran have been adversely affected since the Islamic Revolution of 1979. Faced with a potentially nuclear Iran, still governed by radical tendencies that defy and challenge American interests, Washington hopes a deal on the nuclear issue could also herald the beginning of a new era with Tehran that would gradually replace hostilities with normal diplomatic relations. Despite the absence of direct diplomatic ties it has been the United States, who has led international efforts to halt Iran's nuclear programme. Even though all other players share US objectives in this instance, none has been as pressing (lest they risk losing Iranian lucrative gas and oil deals) and instead have been quite happy to see the United States play the major role.

US government would naturally expect a return for their efforts. A nuclear deal with Iran without agreement on the normalisation of ties would basically mean that Washington has done the hard work for the rest of the world free of charge. In fact, post a settlement certain groups within Iran may wish to further radicalise domestic political atmosphere against the United States accusing American government with imposing the nuclear compromise. They may also have a corresponding impact on Iran's proxies outside its borders like Hezbollah in Lebanon, Houthis in Yemen, Islamic Jihad in Palestine and other such groups throughout the Middle East. Therefore, any deal with Tehran should preferably include an understanding to the effect that the Islamic Republic would desist from radicalisation of politics in the neighbouring countries and engage in a more conciliatory framework with the United States to address regional problems. One of the most pressing issues is the Syrian case. Absent the use of force by the United States, it seems that Iranian and Russian support for the Assad regime can sustain him in power. With around 250,000 killed so far, millions displaced and no solution in sight the situation is desperate for some new thinking, which will have to take the Iranian position into account. Needless to say the agreement of Tel Aviv would also be crucial, as no solution could perceivably work without the Israeli support.

## **7.6. The European Union (EU)**

The three leading European countries dealing with Iran are Germany, France and the United Kingdom. The relationship is vast and deep. It includes working on Iranian oil and gas fields (mainly by BP, Shell and Total though no details have

ever been released either by the Iranian government or the oil companies), facilitating and at times financing the Islamic Republic's global transactions, providing insurance for tankers carrying Iranian oil and exporting goods to the Iranian market. The political alliance of the EU and Washington during the Cold War has in some instances in the new era given way to competition. Iran is a case in point. Although in some goals the EU and the United States find commonality, the near-monopoly of Europeans over Iran's oil and gas is something they had rather not share with their American cousins.

It follows that as much as the EU would like to see Iran forego its nuclear ambitions, it would be just as uncomfortable with an Iran that may allow in competition to European companies. Therefore sanctions are desirable for the EU as long as they impact only Iran's nuclear policy but do not change the Islamic Republic's international orientation. The fine balance between pressuring Iran to change its nuclear policy on the one hand and not threatening the very survival of the regime on the other is a delicate task the EU has succeeded in so far. The removal of EU sanctions from Iranian Oil Tanker Company in October 2014 illustrates the point (The Times of Israel, 2014).

The EU seems to have done rather well with regard to nuclear negotiations with Iran. When over a decade ago the foreign ministers of France, Germany and the United Kingdom got involved in the negotiations their main objective was to thwart a military action either by the United States or Israel against Iran's nuclear facilities. They achieved that and in the process they also managed to boost their claim for a greater global role (Adebahr, 2014). The EU's former chief foreign policy diplomat, Katherine Ashton, has been a key figure in conducting negotiations with Iran.

## 7.7. Israel

Arguably the Islamic Republic has been the most vocal enemy of Israel ever since the Revolution. Ayatollah Khomeini called for the destruction of the Jewish state to be repeated by other senior figures in Iran ever since. Israel, on its part however, may have been too happy to see the Iran–Iraq war dragged on for eight years (weakening both countries) and to note the Iranian support for Hamas, which has divided the Palestinian front. Also in Syria, as long as it is Israel's opponents who are killing one another, Tel Aviv has no pressing need to intervene or aim for a change. In fact Assad may be a more agreeable and more predictable enemy than some of the Islamist groups seeking to replace him. As things stand at the moment none of the sides in Syria are in any position to pose a threat to Israel.

Rhetoric aside, Iran and Israel may have more in common than meets the eye. Historically the Persian Emperor, Cyrus the Great, liberated the Jews when he conquered Babylon and allowed them to practice their faith freely. The Old Testament mentions his name 23 times and refers to him as the patron and the deliverer of the

Jews. Politically, the two countries have an important commonality in that they are both regarded as enemies by many Arab countries. The Islamism of the revolutionary establishment in Tehran has failed to bridge the gap that divides Sunni Arab countries from the Shi'a Iran. Moreover 'Israel does not represent a threat to Iran's national security' (Bahgat, 2007, p. 13). Equally it should be noted that since the coming of Islam some 1400 years ago Iran has never sided with Muslims in violent conflicts. During the Crusades Iran largely kept out of the fighting; in fact later on it fought the Muslim Ottoman Empire for nearly 200 years and its most recent war was with its Muslim neighbour Iraq. The above provides only a rough historical sketch of Iran's place in the region and does not aim to indicate that current political developments can be overlooked in examining the Islamic Republic vis-à-vis Israel.

Notwithstanding the above Israel may find listening ears in the global arena when it voices concern over the nuclear programme of a country that has repeatedly stated its desire to wipe it off the map. Hezbollah, sustained by Iran, has also proved its capabilities in launching rockets into Israeli territory causing deaths and instilling fear in the civilian population. Its leader, Hassan Nasrollah has stated that his organisation had achieved success where 'big Arab armies had been defeated' (Reynolds, 2006). The deterrent quality of the Israeli armed forces seems to have somewhat dissipated. Iran has also played a huge part in the Islamicisation of the Arab-Israeli dispute, which both deepens and broadens the conflict. The important question is how Israel can live with Iran in the same region, when Iran has actually become a potential nuclear power with medium range missiles that can reach Tel Aviv.

Israel does not have the military prowess to attack Iranian nuclear sites on its own. It needs US support. However, the Obama Administration is unwilling to commit to another military engagement and no one in Israel has any illusions about that.<sup>6</sup> Washington would be ill-advised to do the hard work of the international community (destroy Iranian nuclear infrastructure militarily) and then get blamed for it by the international media for having violated another country's territorial integrity whilst the rest of the world would reap the benefits of the US military action (sanctions would be waived with the removal of nuclear risk) by doing business as usual with Iran. In the meantime the Iranian government would turn even more anti-American and a few years down the line Washington could be facing the same scenario again; all of which leaves Tel Aviv with the daunting prospect of ensuring Tehran's progress in nuclear technology is halted at least until Obama leaves the White House. Sanctions appear to have achieved that goal to an extent for now. However, a nuclear agreement could lead to the removal of sanctions, and that could in turn untie the hands of the establishment in Tehran to renew its effort for nuclearisation.

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<sup>6</sup>This was stated to the author in a private conversation by a retired Israeli army general.



## 7.8. Russia and China

Russia is now the main supporter of the Islamic Republic in the international arena. It has the same policy as Iran on Syria, it has repeatedly worked against adoption of harsher measures against Tehran in the UN Security Council, it has built the Bushehr nuclear reactor in Iran (albeit with years of delay) and has just signed a military agreement with the rulers in Iran. Iran has sought to procure S-300 missiles from Moscow but international pressure has so far prevented that deal. Such advanced surface to air missiles system, Tehran believes, would act as a powerful deterrent against any military operation against Iranian nuclear sites.

Russia is also profiting handsomely from its relations with Tehran. It has proposed to reduce the Iranian share of the Caspian shore from 50% to much lower percentage. The clerics in Tehran have also turned a blind eye to the plight of Chechen Muslims at the mercy of Russian armed forces. Tehran's support for the Assad regime is also in line with Moscow's policy of maintaining the current Syrian government lest Russia's access to the Mediterranean Sea could be at risk. And of course Iran's anti-Americanism helps Moscow internationally in its new war of words with the West (particularly after the crisis in Ukraine and the annexation of Crimea) and hinders US hegemony in the Middle East.

None of the above advantages would be lost to Moscow in the post-nuclear-settlement era with the possible exception of Iranian anti-Americanism. The latter would depend on the kind of deal reached: a minimalist outcome would still leave the anti-American stance of the Islamic Republic intact and keep US companies out of Iran whilst it would secure a halt to the nuclear programme that is suspect by the international community. A maximalist outcome, however, would see a considerable shift in Iranian foreign policy that would erode its anti-Western edges (which would include resumption of ties with Washington) as well as bring an end to the part of Iran's nuclear ambitions that trouble the world. And a moderate outcome would probably see some changes, at least temporarily, in Iran's external relations without shifting orientation and at the same time Tehran's full cooperation with the International Atomic Energy Agency would be secured.

Obviously Russia would prefer the minimalist approach, where Tehran and Washington would still be at loggerheads with one another. Accordingly Moscow would be trying to convince Iran that all its needs can be met by Russia once a nuclear agreement is arrived at. The point not lost to Russian officials is that after Iran and the Five plus One make a deal, Washington could decide to reward Iranian compromise, in economic terms at least, and Tehran may actually welcome that. That could have a spillover effect and trigger a thaw in Iran-US relations.

In the early years of the Revolution China supplied much light weaponry to the Islamic Republic. Eager to replace hegemony in the international arena with multi-polarity, Beijing welcomed expansion of relations with the Islamic Republic on the basis of countering the US and the Soviet Union influence (Currier & Dorraj, 2010). The three basic elements that have characterised China-Iran

relations are military/strategic, financial and energy related. The last two, however, have become far more prominent after the fall of the USSR as former Soviet republics rushed to secure buyers for their armaments and therefore competed with China.<sup>7</sup> Later as the 'factory of the world' China managed to supply Iran with many consumer goods (to the detriment of the local suppliers), sometimes in a barter trade for oil, where transfer of money to Tehran did not prove possible under the sanctions regime. As the fastest developing economy in the world, Beijing also needed cheap and stable energy supply, which Iranians were happy to provide China with.

Though Iran was never a colony, during most of the Qajar period Russia and the United Kingdom intervened in Iran's domestic politics, which has left an unpleasant legacy in Iranians' collective memory. The United States also was complicit in the 1953 coup. China is in the enviable position of not sharing those traits and appears to have a clean record of non-intervention in Iranian affairs.

Russia has now clearly overtaken China as the main supplier of arms to Iran supplying over 70% of Iran's needs (Currier & Dorraj, 2010, p. 57). The Iranian air force though has remained mainly American albeit very aged and out of date. Should the nuclear agreement be a minimalist one as described above, it may be that the Islamic Republic will turn to Moscow to rebuild its air force. That would make the Islamic Republic more dependent on Russia for its security needs.

## 7.9. Conclusion

The nuclear negotiations between the Five plus One and the Islamic Republic of Iran are expected to conclude before the summer of 2015. Indications are that the religious government in Tehran has no option but to accept the terms demanded by the international community. The sanctions regime is clearly taking its toll on the Iranian economy and the very survival of the Iranian establishment may now be hostage to the removal of sanctions.

The relationship between Iran and the West, and in particular the United States, in the aftermath of a nuclear agreement is influenced by several factors. Arguably the most important element will be the nature and the scope of the agreement. Will the agreement lend itself to a resumption of diplomatic and commercial ties between Tehran and Washington or will it be just a minimalist deal that will remove the immediate threat of Iran's nuclearisation as perceived by the outsiders? Arguably Iran could benefit from renewed bonds with the United States but there are powerful interests both inside and outside of Iran who would do everything in their power to preclude such a development. However, as against that, after 36 years of revolution, the great majority of Iranians are left disillusioned and would welcome the

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<sup>7</sup>China's arms export in 1996 had been reduced to less than 1% of its total currency earner.

prospects of new beginnings and normalisation of their country's international relations. Whether or not those sentiments can turn into reality will largely depend on the diplomacy of the most powerful country in the world.

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## **PART III**

# **IRAN AND KEY GLOBAL PLAYERS**



## Chapter 8

# India and Iran Trade: Issues and Challenges

Rakesh Mohan Joshi

### Abstract

India and Iran historically share centuries-old strong socio-cultural and trade relations since ancient times. The chapter explores emerging opportunities and challenges in trade and investment in the present era. While Iran is one of the leading producers and exporters of oil, India, a major market for hydrocarbons, is heavily dependent on imports to meet its domestic requirements. This offers trade complementarities between the two countries as India is a secure market for Iran's oil whereas Iran facilitates India to decrease its over-dependence for oil on Saudi Arabia. This chapter discusses the mutually beneficial trade relationship as well as potential for further deepening the existing economic ties between these two ancient civilizations that could offer a win-win situation for both countries.

**Keywords:** India-Iran trade relations; trade and investment; growth share analysis; composition of trade; bilateral relations; gas pipeline

## 8.1. Historical Background

India-Iran relations historically have centuries-old socio-cultural and trade relations traceable to ancient India. The Indus Valley Civilization, one of the early civilizations of the old world located in ancient India, was contemporary with the

Proto-Elamite and Elamite civilizations in ancient Iran. The Indus people had socio-cultural and trade links with the people of ancient Iran. During the Vedic civilization era in India, the languages of Indo-Aryan family had originated from Indo-Iranian language family. The ancient Vedic religion and the religion of ancient Iran (Zoroastrianism) had many similarities. During the Maurya Empire in India, trade expanded sharply due to the introduction of coinage in Iran. India exported spices like black pepper and imported gold and silver coins from Iran. During the eleventh century and afterwards, several poets, artisans, and religious people from Iran came to settle in India and consequently along with Islam, the art and architecture of Iran had a great influence on every walk of Indian society (Nehru, 1992). The two countries shared a common border till 1947.

The present chapter explores the emerging opportunities and challenges in trade and investment in the present era. During the recent years, the economic considerations have become increasingly important over political considerations in international relations. Though, India had always been dependent on import of hydrocarbons to meet its domestic needs, but it met about two third of its requirement through domestic production. However, since country's economic liberalization in 1991, the need for import of hydrocarbons increased rapidly to cope up with India's economic growth and the country's import dependence for oil has grown considerably. Therefore, the relationship between Iran and India are complementary in nature as India offers a stable market for oil-rich Iran.<sup>1</sup>

Iran ranks fourth in world oil production and third in oil exports. These levels of reserves and production make Iran a natural partner for energy-hungry India. Iranian oil provides opportunities to India to maintain a diversified oil basket and avoid an overreliance on Saudi Arabia, which has been a principle supplier of oil to India. India has keen interests in diversifying its energy supply. Given this perspective India has moved closer to Iran, a country possessing rich resources of oil and natural gas, which has third largest reservoirs of energy resources in the world. India imports crude oil from Iran while India exports diesel to Iran. The rapid economic growth that took place in India during the last few decades has heightened its need for cheap energy resources supplier. This compelled for vital relations with countries possessing abundant energy resources which could be supplied to India at cheap prices.

## 8.2. India-Iran Trade

In 2013, India was the third largest market of Iran's exports with a share of about 16% after China and Turkey, whereas it was the second largest importer of Iran

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<sup>1</sup>*The New Delhi Declaration: The Republic of India and the Islamic Republic of Iran*, 25 January 2003, Ministry of External Affairs, Government of India.

with 11.1% share after China. Trade relationship between Iran and India have witnessed a significant rise during the last decade, with India's total trade (exports plus imports) with Iran rising from US\$1.16 billion in 2003 to US\$15.47 billion in 2013. This buoyant trend has been supported by both rise in India's exports to and imports from Iran, with India's imports from Iran showing a much higher CAGR (43.67%) as compared to India's exports (19.79%) to Iran (Table 8.1). India's trade balance with Iran which showed a surplus of US\$0.63 billion in 2003, turned into a deficit of US\$4.3 billion in 2006 owing to sharp increase in oil imports.<sup>2</sup>

Total trade declined in 2009 mainly reflecting sharp fall in export demand, before picking up in 2010. The unilateral economic sanctions imposed on Iran have had an adverse effect on the bilateral trade as the international banking channels have gradually become non-existent. In 2013, Iran was India's 19th largest export market, with a share of 1.61% of India's total export. During the same year Iran was the 17th largest source of imports for India, with a share of 2.15% of India's total imports (Table 8.2).

The bilateral trade between India and Iran, at its current level, hardly reflects its optimum potential. Iran's share in India's total exports was only 1.61% in 2013. Total exports of India to Iran in 1996 was US\$194.96 million, in 2013 it increased to over US\$5433.90 billion. India's exports to Iran registered a maximum growth of 111.26% from 2012 to 2013. As can be seen in Figure 8.1, there was considerable drop in the exports from India to Iran from 2008 to 2009, with a decline of -16.56%. There is significant increase in imports from Iran to India since 2006. As regards India's imports from Iran, mineral fuels dominate the imports basket, accounting for as much as 80% of India's total imports from Iran<sup>3</sup> in 2013. Huge trade deficit with Iran, primarily due to high crude oil import, have raised concerns over the years.

### **8.2.1. Composition of India's Exports to Iran**

India's exports basket to Iran is dominated by cereals and residues and waste from the food industry with these two items accounting for a significant 57% of India's total exports to Iran in 2013. This is followed by other products like electrical machinery and parts, iron and steel, organic chemicals, nuclear reactors and boilers, coffee, tea and spices, meat and edible meat offal, chemical products. During 2003–2013, India's exports to Iran have risen, from US\$0.89 billion in 2003 to US\$5.43 billion in 2013, mainly due to rise in exports of cereals, residues and waste from the food industry, iron and steel and electrical machinery and parts (Table 8.3).

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<sup>2</sup>Based on data from World Integrated Trade Solution (WITS).

<sup>3</sup>Based on data from World Integrated Trade Solution (WITS).



Table 8.1: India-Iran bilateral trade (figures in billion US\$).

Year	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	CAGR (%)
Export	0.89	1.18	1.07	1.62	1.85	2.34	1.95	2.51	2.46	2.57	5.43	19.79
Import	0.27	0.36	0.64	5.92	9.17	13.79	10.59	11.08	11.49	13.35	10.03	43.67
Total trade	1.16	1.54	1.72	7.54	11.01	16.13	12.54	13.59	13.95	15.92	15.47	29.56
Trade balance	0.63	0.83	0.43	-4.30	-7.32	-11.46	-8.64	-8.57	-9.03	-10.78	-4.60	

Source: Calculations based on World Integrated Trade Solution (WITS).

Table 8.2: India-Iran trade: Growth share analysis.

Year	Exports from India	% Growth	% Share of Iran with Total Exports	Imports by India	% Growth	% Share of Iran with Total Imports
1996	194.96		0.58	859.99	NA	2.20
1997	171.61	-11.98	0.49	632.17	-26.49	1.53
1998	158.72	-7.51	0.48	474.17	-24.99	1.12
1999	152.96	-3.63	0.41	1258.22	165.36	2.52
2000	187.34	22.48	0.44	702.36	-44.18	1.33
2001	253.28	35.20	0.58	266.94	-61.99	0.53
2002	492.19	94.33	0.98	254.16	-4.79	0.44
2003	892.99	81.43	1.50	267.69	5.32	0.37
2004	1185.00	32.70	1.56	355.92	32.96	0.36
2005	1072.99	-9.45	1.07	644.17	80.99	0.46
2006	1617.34	50.73	1.33	5918.06	818.71	3.32
2007	1845.26	14.09	1.26	9165.58	54.87	4.19
2008	2335.91	26.59	1.28	13,791.49	50.47	4.37
2009	1949.09	-16.56	1.10	10,591.67	-23.20	3.98
2010	2509.26	28.74	1.14	11,078.29	4.59	3.16
2011	2462.29	-1.87	0.82	11,488.13	3.70	2.48
2012	2572.13	4.46	0.89	13,349.28	16.20	2.73
2013	5433.90	111.26	1.61	10,031.59	-24.85	2.15

Source: Calculations based on WITS.

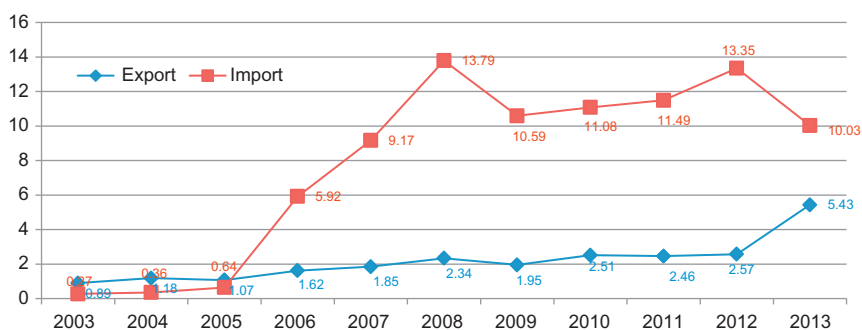


Figure 8.1: India's exports and imports from Iran (in billion US\$).

Source: Based on WITS.

### 8.2.2. Composition of India's Imports from Iran

Mineral fuels dominate the import basket, accounting for as much as 80% of India's total imports from Iran in 2013 (Table 8.4). Iran is also a major source for India's imports of fertilizers, organic chemicals, plastics and articles thereof, as well as iron and steel, edible fruits and nuts, aircraft, spacecraft as given in Table 8.4.

India's bilateral engagement with Iran may potentially be affected by the 'Comprehensive Iran Sanctions, Accountability and Divestment Act of 2010' which was signed into law by President Obama on 1 July 2010. The Act has broadened the scope of activities under purview of sanction to Iran's energy and other sectors and has also sought to make sure that the sanctions are enforced.

India had to cut oil imports from Iran, after sanctions imposed by the United States and the EU. India's crude imports from Iran has decreased by more than 26.5% during the period 2012–2013 as US and European sanctions on Tehran make it difficult for Indian refiners to import Iranian oil through ship (see Table 8.5).

Imports of Iranian crude fell to 13.3 million metric ton (mt), or close to 267,100 barrels per day (b/d), in 2012–2013 from 18.1 million mt, or around 362,500 b/d, in 2011–2012. Imports from Iran were as high as 21.2 million mt, or 425,000 b/d, in 2009–2010 before dropping to 18.5 million mt, or 371,520 b/d in 2010–2011. Despite this fall in India's import of Iranian crude oil in recent years, Iran remains the second largest supplier of crude oil to India, and consequently India is one of the largest foreign investors in Iran's oil and gas industry.

### 8.2.3. Exploring Potential Areas for Enhancing Bilateral Trade

Bilateral trade between India and Iran witnessed a considerable growth, with total trade between the two countries having stood at US\$15.47 billion in 2013. India's

Table 8.3: Composition of India's exports to Iran, 2003–2013 (in million US\$).

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Cereals	3.46	4.02	1.51	12.50	3.69	95.18	505.37	369.00	584.81	909.64	2300.24
Residues and waste from the food industry	6.52	18.29	0.45	0.81	14.43	16.27	29.67	20.31	63.61	158.20	835.03
Electrical machinery and parts	20.13	18.38	29.94	44.51	71.89	73.20	69.48	90.43	86.07	116.50	264.50
Iron and steel	95.55	84.51	149.70	133.62	180.10	180.32	199.39	192.02	208.59	124.99	245.17
Organic chemicals	52.64	51.63	54.73	100.59	91.14	91.79	87.34	90.85	97.00	102.11	198.29
Nuclear reactors, boilers	27.31	54.03	68.78	75.04	78.36	144.13	118.75	140.63	139.87	126.62	153.07
Coffee, tea and spices	2.29	20.47	20.43	24.18	41.17	56.95	44.79	76.41	74.34	71.86	133.44
Meat and edible meat offal	7.13	8.60	14.56	27.44	20.58	26.16	11.12	44.07	77.71	132.44	133.21
Man-made staple fibers	5.00	11.87	10.01	19.00	20.08	18.83	38.05	67.11	103.15	58.10	95.95
Chemical products	10.09	15.42	24.32	26.91	35.93	47.17	35.03	36.38	49.03	42.48	88.46

*Source:* Based on WITS.

Table 8.4: Trends in India's import of major commodities from Iran, 2003–2013 (in million US\$).

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Mineral fuels, oils and product	4.12	17.92	7.10	5076.96	8368.16	12,627.08	9584.41	9530.32	9620.81	11,357.34	8101.19
Fertilizers	0.62	10.73	2.65	1.30	0.13	1.52	74.43	174.74	672.76	683.65	716.75
Organic chemicals	40.95	62.93	141.00	149.83	205.63	294.18	373.42	384.48	348.01	498.62	501.82
Inorganic chemicals	15.88	25.64	47.01	84.81	35.87	231.53	106.66	166.12	378.75	314.11	271.44
Plastics and articles thereof	1.82	1.65	4.20	29.58	8.58	11.01	55.08	141.12	81.19	132.95	139.66
Iron and steel	7.51	48.76	152.12	140.78	90.19	9.23	48.92	36.90	2.84	77.66	74.04
Miscellaneous chemical products	0.20	6.89	2.61	16.06	16.15	25.80	27.75	30.45	67.05	27.96	66.37
Edible fruits and nuts; peel of citrus fruits	50.05	42.22	53.78	60.92	69.50	51.94	30.92	44.17	50.91	50.76	62.67
Aircraft, spacecraft and parts	0.00	0.02	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.05	23.25
Salt, sulfur, earth, stone, plaster	46.14	33.35	40.72	34.15	41.16	156.25	23.24	62.98	115.30	129.29	18.41

Source: Calculations based on WITS.

Table 8.5: Decline in India's import of Crude Oil from Iran.

Year	India's Import of Crude Oil (in million metric ton per day)	India's Import of Crude Oil (in barrels per day)
2009–2010	21.2	425,000
2010–2011	18.5	371,520
2011–2012	18.1	362,500
2012–2013	13.3	267,100

Source: Based on data from Director General of Foreign Trade, Government of India.

bilateral trade balance with Iran shifted from a surplus of US\$0.63 billion in 2005 to US\$11.46 billion in 2008 but declined to US\$4.60 billion in 2013.

To identify potential items of India's exports, major items in Iran's imports and India's percentage share in its imports was found out based on HS code as given in Table 8.6. Based on low share of India in Iran's import basket of major commodities, potential items were identified. The excerpt of such analysis as given in Table 8.6 reveals Iran's major 20 import items, in terms of two-digit HS code, and India's share in Iran's global imports of these items.

As depicted in Table 8.6, India's share in Iran's major imports is still low, except for cereals (HS-10), articles of iron and steel (HS-72), organic chemical (HS-29), residues, wastes of food industry, animal fodder (HS-23) and man-made filaments (HS-54). Therefore, Table 8.6 reveals the potential for export of all those items<sup>4</sup> that account for high total value of exports but India's share is much less. This calls for product-specific export strategy to Iran.

### 8.3. Collaborative Infrastructure Development to Promote Trade

India and Iran are also working along with Pakistan on an ambitious project (*The Hindu*, 2014) to lay down a 2700 km long pipeline, stretching 1100 km in Iran, 1000 km in Pakistan and 600 km in India and estimated to supply 60 million cubic meters of liquefied natural gas (LNG) per day to Pakistan and 90 million cubic meters of LNG per day to India, or about 20% of its anticipated demand by 2030.

India is also actively involved in infrastructure development in Iran such as development of Chabahar port as an alternative to Bandar Abbas, which is about further 380 miles away. India, Iran, and Afghanistan have an agreement on preferential

<sup>4</sup>Based on data from Trade Map.

Table 8.6: Iran's major imports and India's share, 2013 (in '000 US\$).

Product Code	Product Description	Iran's Imports from World	Iran's Import from India	India's Percentage Share in Iran's Imports	India's Worldwide Exports
Total	All products	48,791,245	5,433,901	11.14	336,611,389
'84	Machinery, nuclear reactors, boilers, etc.	6,192,391	153,071	2.47	13,126,148
'10	<i>Cereals</i>	4,940,285	2,317,481	<b>46.91</b>	11,592,455
'85	Electrical, electronic equipment	3,762,694	264,516	7.03	11,275,864
'18	Cocoa and cocoa preparations	3,246,816	51	0.00	82,871
'72	<i>Iron and steel</i>	2,284,069	245,172	<b>10.73</b>	10,206,482
'15	Animal, vegetable fats and oils, cleavage products, etc	1,880,395	4925	0.26	984,201
'39	Plastics and articles thereof	1,874,068	52,584	2.81	6,222,703
'71	Pearls, precious stones, metals, coins, etc	1,704,363	11,446	0.67	44,157,662
'23	<i>Residues, wastes of food industry, animal fodder</i>	1,591,159	835,029	<b>52.48</b>	3,697,493
'73	Articles of iron or steel	1,519,270	52,955	3.49	7,347,626
'87	Vehicles other than railway, tramway	1,493,096	27,004	1.81	13,800,069
'90	Optical, photo, technical, medical, etc apparatus	1,396,256	22,283	1.60	2,288,877
'48	Paper and paperboard, articles of pulp, paper and board	1,337,621	69,049	5.16	1,141,261
'30	Pharmaceutical products	1,311,346	76,823	5.86	11,731,941
'29	<i>Organic chemicals</i>	884,304	198,899	<b>22.49</b>	13,340,364
'94	Furniture, lighting, signs, prefabricated buildings	800,034	598	0.07	1,193,881
'40	Rubber and articles thereof	674,829	39,091	5.79	2,974,672
'54	<i>Man-made filaments</i>	542,014	54,183	<b>10.00</b>	2,680,862
'44	Wood and articles of wood, wood charcoal	527,234	1525	0.29	351,497

Source: Calculations based on Trade Map.

treatment and low tariffs for goods moved through Chabahar port, which also has a free trade and industrial zone in its locality. India's existence at the Chabahar port can straightforwardly be accessed from India's western coast. This would also facilitate a sea-land access route into Afghanistan through Iran's eastern borders (*The Times of India*, 2014).

#### **8.4. Conclusion: India-Iran Trade Relations — A Win-Win Situation**

The above analysis reveals that the bilateral trade between the two countries grew considerably from US\$1.16 billion in 2013 to US\$15.47 billion in 2013. Over the years India's import dependence for hydrocarbon sector has increased considerably leading to trade deficit from Iran. India has become a major source for Iran's imports of organic chemicals, cereals, articles of iron and steel and man-made staple fibers. As Iran faces economic sanctions from the United States and the EU, India offers a stable market for export of petroleum products from Iran on one hand whereas Iran provides the much needed petroleum products for imports to India at highly reasonable prices. Thus, the economic and trade relations between India and Iran are of highly strategic nature and offer a win-win situation for both countries.

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## Chapter 9

# Iran—China Relationship: Implications for the West

Mohammad Elahee and Jiayong Gao

### Abstract

This chapter describes the historic ties between two ancient civilizations — Iran and China and how this relationship has evolved over the past few decades. The current state of trade and investment relationship between the two countries is discussed, followed by an analysis of the geopolitical implications of the evolving relationship between Iran and China. The chapter concludes by showing how ties with Iran can give China access to the greater Middle East.

**Keywords:** Oil; LNG; Silk Road; Shanghai Cooperation Organization

### 9.1. Introduction

As one of the few continuing ancient civilizations, Iran, throughout history, has played an important role in connecting people across countries through trade and commerce. Because of its strategic location that straddles Western and Central Asia, large oil and gas reserve, an educated workforce, a large diaspora that can be found in every continent of the world, and centuries-old cultural influence in the region, Iran is likely to remain an important player in international trade and commerce as well as in global diplomacy and politics. Therefore, Iran's bilateral

relationship with any major power of the world is likely to reverberate beyond the borders of these two countries and become a matter of strategic interest for others. Especially, the Sino–Iranian relationship, according to a Rand Corporation report by [Harold and Nader \(2012\)](#), creates unique challenges to US interests and objectives in the region.

The focus of this chapter is Iran’s relationship with China, which is Iran’s largest market for oil export, its principal source of imports, and overall, its largest trading partner, according to trade data available from the United Nations Conference on Trade and Development (UNCTAD). Iran is a member of the Shanghai Cooperation Organization (SCO), a regional body created and nurtured by China to foster cooperation among countries in Central Asia and its periphery. China is also one of the largest investors in the Iranian oil and gas sector, which is explained in greater detail later in the chapter.

This chapter provides an overview of the historical relationship between Iran and China followed by a discussion of the current state of trade and investment between the two countries and concludes with a discussion of the implications of this relationship for the West.

## 9.2. A Historical Overview of Iran–China Relationship

Iran and China are natural allies in many different ways. Both are heir to ancient civilizations which continue even to this day, despite interruptions at various points in history. Both Iran and China feel they were humiliated by Western powers at different periods of history — China by seven Western powers which Chinese people consider as “One hundred and fifty years of humiliation” ([Kissinger, 2011](#)) and Iran by British and US interference in their domestic affairs since the beginning of the 20th century. Such humiliation by Western powers may create a sense of shared sufferings and psychological affinity among people of Iran and China. As a result, both Iran and China are suspicious about the long-term motives of Western powers in this region. China and Iran are also two countries which never had any direct military confrontation in their shared 3000 years of history that makes them more trusting of each other.

The diplomatic and trade relationship between Iran and China can be traced back to as early as 139 BCE during the period of Han dynasty in China and Parthians in Iran ([Dorraj & Currier, 2008](#)). The ancient “Silk Road” that connected China with Middle East and Europe went through Iran. Many of the Chinese inventions such as paper, compass, gunpowder made their way to Europe through Arab and Persian traders. According to [Garver \(2006\)](#), there have been cultural ties between the people of Persia (present-day Iran) and China for thousands of years. [Garver \(2006\)](#) also reports that a large number of Persian people settled in South Chinese city of Guangzhou who brought with them Persian cultural influence that

penetrated the Chinese Imperial Court through poetry, polo game, and ritual Zoroastrian dances during the period of Tang dynasty. Garver (2006) further states that the Kingdom of Kushan in the Oxus region played an important role as a center of cultural exchange for the two countries.

The contacts between the people of China and Iran increased significantly under the Muslim rule and got a further boost when both countries came under Mongolian occupation (Dorraj & Currier, 2008). This relationship continued through the centuries during successive dynasties in both countries. However, with the Communist takeover of China in 1949, the relationship between Iran and China came to a sudden halt. Iran at that time, under the regime of Reza Shah Pahlavi, was a staunch Cold War ally of the United States and distrustful of communist regimes. China's support for the communist Tudeh Party in Iran created further distrust about China's motives.

The frozen relationship between Iran and Communist China started thawing in the 1950s and both countries began trading with each other in 1960 (Park, 2011), although it took another decade for Iran and China to formally establish diplomatic relationship in 1971. By then, China had an ideological split with the former Soviet Union and started secret negotiations with the United States through Pakistan. Once the diplomatic relationship between Iran and China was reestablished, the trading relationship grew quickly. As compared to 1971, the trade between China and Iran rose sixfold within a year in 1972 and 20 times within six years in 1978, which gives an idea of the rapidly rising trading relationship between the two countries. After a brief drop in 1979 in the wake of the Islamic Revolution, the trade between the two countries began rising throughout the 1980s and 1990s, a trend that continues till to date. The various sanctions imposed by the United States and its allies pushed Iran into China's fold, which is perhaps one of the unintended consequences of the US policies toward Iran. In 2009, Iran officially declared its "Go East Policy" and joined the Shanghai Economic Council. The mutually beneficial dynamic relationship between Iran and China has also resulted in Iran becoming an important buyer of Chinese arms and ammunitions. In 2014, Iran and China held the first ever joint naval exercise in Iranian water, which, according to Heydarian (2014), signals China's desire to have a strategic presence in one of the most important maritime regions of the world.

### **9.3. Current Business Relationship between China and Iran**

The Iran–China relationship has grown significantly since Iran established diplomatic ties with the People's Republic of China in 1971, and more so, in the last 36 years when Iran's relationship with the West started deteriorating. In the period between 1995 and 2013, the bilateral merchandise trade between the two countries grew from a modest US \$220 million to over US \$29 billion dollars (see Table 9.1).

Table 9.1: Iran–China trade 1995–2013 (in thousands of US dollars).

Year	Export to China	Export to Hong Kong, SAR	Import from China	Import from Hong Kong, SAR	Total Trade
1995	214,521.9	12,735.88	277,889.317	6171.962	220,693.9
1996	290,618.602	223,010.744	394,580.868	8282.12	298,900.7
1997	526,224.2	97,915.38	496,446	9953.664	536,177.9
1998	479,405	36,628.66	656,503	17,876.22	497,281.2
1999	748,541.7	44,613.26	662,733.7	9446.372	757,988.1
2000	1,731,066	45,549.3	713,440.6	16,664.71	1,747,731
2001	2,306,157	58,619.55	888,580	30,943.54	2,337,101
2002	2,787,170	129,010.3	1,393,303	26,558.61	2,813,729
2003	3,344,856	166,708.1	2,315,162	37,552.84	3,382,409
2004	4,697,547	139,883.6	2,554,761	49,894.44	4,747,441
2005	7,179,284	217,899	3,296,585	61,365.18	7,240,649
2006	9,712,516	177,600	4,488,952	85,071.6	9,797,588
2007	12,378,084	208,308.7	7,363,292	83,114.93	1,246,199
2008	17,266,358	212,196	8,163,428	106,368.1	17,372,726
2009	15,087,706	177,976.2	7,918,687	100,745.8	15,188,452
2010	17,652,539	402,705.5	11,092,188	130,779.7	17,783,319
2011	27,907,055	248,683.8	14,761,999	185,523.7	28,095,279
2012	28,687,491	339,897.8	11,598,799	156,399.7	28,843,891
2013	28,990,683	313,762	14,036,645	123,385.8	29,114,069

Source: UNCTAD data (2015).

The figure would actually be considerably higher if China's trade with the United Arab Emirates (UAE) based Iranian companies are included (*Al Tamimi, 2013*).

Although oil and gas are the main driver of Iran–China business dealings, the business relationship between the two countries is actually much broader and deeper than what a casual observer may notice. For example, a cursory review of the items traded by Iran and China reported in publicly available websites such as the UNCTAD or the World Integrated Trade Solutions maintained by the World Bank show that China is a major trading partner of Iran in areas as diverse as arms trade, rail and road infrastructure, mining, transportation, power generation, and various consumer goods such as auto parts, electronics, textiles, and toys. The trade figures between Iran and China from 1995 to 2013 are given in *Table 9.1*. As *Table 9.1* shows, the overall trade between the two countries registered consistent growth on a year to year basis except a few years when new sanctions were imposed such as in 1997–1998, 2009, and 2012.

Due to Western sanctions, investment in Iranian oil and gas sectors has suffered considerably in all areas including exploration, refining, and downstream

production. In the absence of Western investment, China has invested in this sector to the extent possible under various types of sanctions. Because of its location between the Persian Gulf and the Caspian Sea, Iran could offer China a westward source of oil (Al Tamimi, 2013). With a view to reduce its dependence on Middle Eastern oil and also to diversify its energy sources, China indeed has decided to build pipeline access to the Caspian Sea region via Iran. As part of its plan to expand trade, China has also mooted the idea of building a new “Silk Road Economic Belt” (Xinhuanet, 2013) and a “Maritime Silk Road” (Krishnan, 2014). Iran will be an integral part of both Silk Roads.

While China’s oil trade with Iran began in the 1970s during the Shah’s time, such trade between the two countries received a significant boost in 1999 when China announced that it would increase its oil import from Iran from 70,000 barrel per day (BPD) in 1999 to 270,000 BPD by 2000 (Huwaitdin, 2002). This announcement however did not come out suddenly. In fact, by 1988, when Iranian oil pipelines and refineries were damaged due to war with Iraq, Sinopec, the largest Oil Corporation of China had sold oil equipment to Iran (Garver, 2006), which was perhaps the first purchase of non-Western oil equipment by Iran. Later, in 2000, Chinese National Oil Company (CNPC) received a contract worth \$85 million dollars to drill 19 existing natural gas fields in southern part of Iran (Garver, 2006).

Iran discovered a massive oil field in Azadegan in 2000, which is considered one of the largest in the world. Even though the exploration rights were awarded to Japan, in 2004 Iran signed a contract worth US \$20 billion with China to supply the latter with 2.5 million metric tons of liquefied natural gas (LNG) every year for the next 25 years (Howard, 2007). This agreement was quickly followed by another agreement between Iranian National Oil Company and Sinopec to sell annually LNG worth \$250 million for the next 30 years (Dorraj & Currier, 2008). Given the scope of such long-term contracts as well as foreign investment in the Iranian oil and gas sector by China, it can be safely concluded that during its isolation from the West, Iran has cemented a long-term economic and trading relationship with China, which is likely to grow significantly as and when UN sanctions on Iran are removed.

#### **9.4. Implications of the Sino–Iranian Relationship**

The deepening business and military relationships between China and Iran have significant economic and geopolitical implications for the West and particularly for the United States. The rise of China has been both a boon and a bane for the United States. The growth of the Chinese manufacturing sector has enabled US-based multinational firms to outsource a significant amount of low-end work to China. This in turn has made it possible for US firms to keep their product prices low and, consequently, US consumers could choose from a wider array of products at an affordable price. The trade surplus that China enjoys with the United

States resulted in a significant outflow of US dollars to China. However, most of these US dollars made their way back to the United States in the form of Chinese Central Bank's investment in US Treasury Bills. The growth of Chinese middle class also created new market opportunities for US firms. This greater economic affluence also enabled China to significantly increase its military spending which has been a cause of concern for the United States. Partly to contain further Chinese influence in the region and beyond, Obama administration announced in 2011 its new policy dubbed as "Asian Pivot", which some observers view as a realignment of US trade, foreign, and defense policy to encircle China. The United States has significantly enhanced ties with countries that are not so friendly with China such as Japan, Philippines, and Vietnam and has also strengthened its ties with its old ally South Korea. The recent signing of a nuclear deal with India during President Obama's visit to India in January 2015 is also viewed by some Chinese experts as a further testament of the US desire to contain China. China, on the other hand, has called for "prudence and caution" in including India in the 48 member Nuclear Supply Group ([Press Trust of India, 2015](#)). As China may feel increasingly encircled by US allies, it may try to develop special relationship with countries that can weaken the impact of this encirclement and this is where the Sino-Iranian relationship becomes strategically important. Just as Germany cultivated close relationship with Ottoman Turkey at the beginning of the 20th century to neutralize British encirclement of Germany ([Anderson, 2014](#)), similarly China may look toward Iran to deny the United States the benefits it seeks by building close military ties with China's neighbors. A strategic relationship with Iran would also give China access to and support from Iranian allies in the region such as Iraq, Lebanon, Syria, and lately Yemen as well as influential non-state entities such as Hamas and Hezbollah.

From Iran's perspective, building a close relationship with China would allow it to minimize the impact of hostile acts by the United States or its Western allies. As a permanent member of the United Nations Security Council (UNSC), China can also veto any resolution that is detrimental to Iranian interests. China can also play a sympathetic role in the ongoing nuclear negotiation between Iran and P5+1, of which China is an important member.

Saudi Arabia, Iran's traditional regional rival, is one of the staunchest allies of the United States in the region. According to classified information divulged by Wikileaks, the late Saudi Monarch Abdullah at one point urged President Obama to "...cut the head of the snake," meaning militarily striking Iran to destroy its nuclear facilities ([The Guardian, 2010](#)). A strong relationship with China would allow Iran to have a global military power on its side. In sharp contrast to relationships with Western countries, which are often transactional and short-term interest based, relationship with China is likely to be more enduring and value based for Iran. Unlike Western countries, and especially the United States, the Chinese government is less likely to interfere in issues that Iran considers purely domestic, such as human rights, women's rights, and freedom of expression.

Iran's isolation from the West, and particularly from the United States, during the last 36 years has allowed China to step in and to partially fill the vacuum, as has been described earlier in this chapter. China already has a formidable presence in various sectors of the Iranian economy such as oil and gas, manufacturing, chemicals, industrial items, machine tools, and various consumer products to name a few. As and when sanctions against Iran are lifted, Chinese firms are likely to have first-mover advantages as they already have built a strong network with the Iranian business and political leaders. While many European firms, particularly from Germany and France, did develop some relationship with Iranian political and business elites, the US firms will have to make extra efforts to make up for the lost time of the last 36 years. Both Chinese and Iranian people are collectivistic, according to [Hofstede's \(2010\)](#) classification. Therefore, both countries value long-term relationships and are less likely to abandon each other as and when Iranian relationship is restored with the rest of the world. Therefore, it is safe to presume that should the UN and Western sanctions against Iran be lifted, Chinese firms will be more prepared than Western firms to reap the benefits of new business opportunities in Iran.

China enjoys a special relationship with Pakistan, which is Iran's southern neighbor. Despite being a close ally of Saudi Arabia, Iran's traditional rival in the region and having differences with Tehran over Afghanistan, Pakistan has been able to maintain a good working relationship with Iran. If China, Pakistan, and Iran can develop an economic belt connecting the three countries, that would not only bring economic benefits, but also significantly reduce Islamic militancy and terrorism in all three countries. China has built a deep water port in Gwadar, in Baluchistan province of Pakistan, which borders the restive province of Iranian Baluchistan. Building an economic corridor in that region could have several benefits. First, the economic development of the provinces of Pakistani Baluchistan and Iranian Baluchistan would create more jobs in these impoverished provinces and reduce political and religious violence which both Iran and Pakistan face from disgruntled Baluch people. China also suffers from intermittent violence and terrorism from Uighur separatists in its western Xinjiang province. Many of these Uighur separatists reside in the lawless areas of Khyber-Pakhtunkhwa and Baluchistan provinces of Pakistan. Economic development of this region could thus be an antidote to Islamic militancy which afflicts all three countries. Second, Iran has been in discussion with Pakistan and India about building a gas pipeline for transporting gas to energy-hungry Pakistan and India that would go through Baluchistan. Although a number of Memorandum of Understandings have been signed, not much progress has been made, mainly due to sanctions on Iran which made it almost impossible to obtain commercial funding for building the gas pipelines. The Iran–Pakistan portion of the pipeline is expected to be completed by 2017. If this pipeline can be enhanced to add a branch to carry gas to Western China, that would further deepen economic ties among the three countries. Third, the Gwadar deep water port used by all three countries would have significant military implications for all countries in the region.



A close tie with Iran would allow China to leverage this relationship when it negotiates other thorny issues with the West such as climate change, human rights, freedom of press, Western support for Taiwan, and Tibet (Al Tamimi, 2013). There is little doubt that in strategic terms, in the modern reenactment of the Great Game where rival powers competed for influence, the interests of Iran and China often converge. In economic terms, that complementarity is no less striking. Iran can continue to satisfy the energy needs of a fast growing Chinese economy to a large extent. In return, China can export not only its product but also its expertise in a number of areas. A case in point is the Tehran subway network, originally slated to be built by the French but eventually constructed by the Chinese. It is true that in some cutting edge technologies, Western know-how is still indispensable; but China is fast narrowing this gap and is increasingly capable to respond to the needs of a country like Iran, thus making it possible for Iran to resist Western political pressure.

In a post sanctions environment, Iran is likely to continue to pursue its policy of turning toward the East, and more specifically build close relationship with China, not only for its own sake, but also as leverage in negotiations with Western political and business interests.

## 9.5. Conclusion

In sum, the evolving relationship between China and Iran is more than a marriage of convenience between two authoritarian regimes as some people might view it in the West. While it is possible that in a post sanction environment, Iran would lessen its tilt toward China and rebuild relationship with the United States, a more plausible scenario is that the Sino–Iran relationship would continue to grow further at the expense of US and Western influence in the region. Iran looks upon China as a bulwark against US global hegemony while China may find a willing partner in Iran that can be used to limit US influence in a region that is an important market and a source of energy needs. While a number of researchers and think-tanks such as the Rand Corporation have been studying the burgeoning Sino–Iran relationship from a political angle, it is important that further research be conducted to gain an appreciation of the business implications of this relationship. It would also be important to examine the limits of Sino–Iran relationship as both countries have divergent interests in many areas which may get accentuated once normal trading and diplomatic relationship between Iran and the West is restored.

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## Chapter 10

# US and Iran: Friends, Foes, or Potential Strategic Partners?

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### Abstract

This chapter traces the history of animosity between the United States and Iran that characterizes the current relationship between the two countries which were once close diplomatic, economic, and political allies. The chapter identifies the various cultural, economic, and political factors that have contributed to the hostility between these two countries and focuses particularly on the UN and US sanctions that have been imposed on Iran because of its overt and covert nuclear programs. The chapter concludes with a discussion on how the lifting of sanctions might allow the United States and Iran to rebuild a strategic partnership.

**Keywords:** Oil and gas; sanctions; nuclear deal; strategic partnership

### 10.1. Introduction

Although the quote is sometimes attributed to Charles DeGaulle or Benjamin Disraeli, it was Lord Palmerston who gave us “*Countries do not have permanent friends; countries have permanent interests.*” One wonders if Lord Palmerston would have approved of a corollary — “*Countries do not have permanent enemies;*

*countries have permanent interests*”? If one has a cursory review of history one can see instances where countries remained antagonistic or hostile to each other over decades or even centuries. England and France perceived each other as adversaries for centuries. This hostility broke out into open conflict on numerous occasions. From the Hundred Years War to numerous continental conflicts that expanded to the New World, such as the French and Indian war, and finally reaching into the 19th century with a series of wars pitting England and its allies against Napoleon. Likewise, the French and Germans saw themselves as archenemies from the Franco-Prussian War to the end of World War II. Yet today, in both instances, we can see these sets of countries are seen as solid allies of each other. Long-term animosities between nations certainly are not limited to Europe. One can find such conflicts throughout history and across the globe. However, hostile relations, even those punctuated by extremely violent wars, need not be permanent state of affairs.

The United States and Iran have had an extremely contentious relationship since 1979. During this 36-year period, the extent of this contentious relationship has ebbed and flowed. Trying to look forward to a possible future state of Iranian and US relationship is fraught with danger. Some, like Bueno DeMesquita (2009), argue that they have tools and techniques at their disposal that would enable them to predict future geopolitical states. I would tend to agree with the Danish physicist Niels Bohr who once jokingly said “*Prediction is very difficult, especially if it is about the future.*” Any attempt to try and forecast the future state of relationships between the United States and Iran should begin with an appreciation that, in most cases, politics and diplomacy is predicated upon national interest. One would have to have a relatively solid understanding of what is perceived as the national interest of the United States within the United States and what is perceived as essential to Iranian interest as seen by the Iranians.

Assuming that nations have permanent interests, one has to appreciate the fact that the perception of those *permanent* interests may change over time. A nuanced interpretation of what constitutes American interests may change from administration to administration and from Congress to Congress. In fact, it is quite possible for the interpretation to change even within a given administration. It is also clear that on the Iranian side of the equation, different administrations have had mutating interpretations of what constitutes Iranian national interests.

In order for us to have any chance of identifying plausible scenarios for future American–Iranian (although it may be chauvinistic, we will use the words America and American as being equivalent to the United States) relationships, we have to understand that the interpretation of what constitutes national interest can be influenced by three major factors — *political, economic, and cultural*. Each of these will be briefly examined, hopefully, laying the groundwork for an understanding of how American–Iranian relations might play out in the near future.

### **10.1.1. Political Factors**

When we look at the notion of the political factors that may affect the nature and extent of the sanctions against Iran, we should immediately say that we are talking about two issues both for the United States and for Iran — internal political considerations and external political considerations. The question of whether to ratchet up or to ease sanctions against Iran has often been a political football in America. At different points in the Clinton administration, there were presidential Executive Orders that tightened sanctions against Iran and then later eased them.

Currently, the tension between the White House and Congress, with regard to sanctions, is significant. President Obama, in his 2015 State of the Union address, argued for continuing the negotiations with the Iranians on the nuclear enrichment issue; while many members of Congress were ardently calling for deepening the sanctions on Iran. There has been disagreement even between President Obama and some Democratic members of Congress over the extent to which sanctions should be used to reduce the *possibility* of the Iranians acquiring nuclear weapons. Although it should be pointed out at times there has been considerable consensus with respect to changing sanctions. In 2013, the United States House of Representatives (both Democrats and Republicans) voted overwhelmingly to toughen sanctions. Unless current diplomatic negotiations yield a successful outcome with respect to Iranian nuclear enrichment and controls that would limit their options to develop nuclear weapons, one can envision considerable conflict between the White House and the Republican-controlled Congress.

In anticipation, the President has threatened to veto additional legislation increasing the sanctions on Iran while some members of the Congress have been proposing exactly the type of legislation. There are elements in the American political landscape besides the White House and Congress that can play a role in determining the future state of US sanctions against Iran. A recent poll indicates that more than 60% of Americans are in favor of continuing the current diplomatic negotiations (Armbruster, 2014). Added to American public opinion is the role of several important constituencies — “antiwar coalitions the US business community and the US security establishment” (Cohen, 2013) which tend to endorse continued negotiations as a way of reaching a diplomatic settlement.

Iran has a comparable situation within their government which is composed of “moderate” and “hardliner” elements (Sengupta, 2013). This dichotomy has existed across several Iranian governments with the presidency sometimes being held by a perceived moderate (Rouhani) and sometimes by a perceived hardliner (Ahmadinejad). Adding to the complexity is the fact that the office of the president of Iran is subsidiary to that of the supreme leader which has been held for the last quarter century by Ali Khamenei. Khamenei has considerable power not only because of his position as supreme leader, but also because of his ability to appoint to many key positions in the Iranian government. Iran’s current President Hassan

Rouhani is perceived to be a moderate and appears to be a strong supporter of the current set of negotiations. One should recognize that his freedom of action is limited by what is acceptable to Khamenei and his advisers.

In addition to the internal political machinations faced by both the United States and Iran, there are external political considerations that should be evaluated before sizing up the possibility of easing or eliminating sanctions. American/Iranian relations do not exist in a vacuum. They are impacted by the relationship that both countries have with other countries, the United Nations (UN), and events in the Middle East.

It is impossible to discuss American/Iranian diplomacy without considering the state of Israel. The Israelis have clearly stated that they view the Iranian nuclear program as a threat to their very existence as a nation. They have also stated that they believe that the chance of a diplomatic solution to the Iranian nuclear program is almost nonexistent. They are strong supporters of maintaining the current sanctions or perhaps increasing the sanctions. Add to this dance the fact that Iran has been a long-time supporter of Hezbollah which the Israelis view as a terrorist organization aimed at Israel. Given the extremely close relationship between the United States and Israel — a relationship that according to intelligence sources included the Stuxnet computer virus attack on Iranian nuclear centrifuges, it is not surprising that Israeli opinion would impact American political decision-making. In January 2015, the speaker of the house John Boehner offered an invitation to the Israeli Prime Minister Netanyahu to speak before Congress. This invitation was enthusiastically embraced by many members of Congress who have argued in favor of increased sanctions. At the same time, Secretary of State John Kerry implied that members of Israeli intelligence felt that any additional sanctions would “throw a grenade” into the diplomatic process. Subsequently, representatives of the Mossad — the Israeli intelligence service — denied that they were explicitly against any increased sanctions against Iran (Sobelman, 2015). This provides just a small taste of the complexities that exist within Israeli politics and the potential impact that it has on American politics.

Another nation with considerable influence on long-term American/Iranian relations is Russia. In the recent past, Russia has, on a number of occasions, undertaken the role of “honest broker” between the two countries. They have made several offers to find an accommodation with regard to finding an arrangement acceptable to both parties with respect to Iran’s nuclear enrichment program. Recent events in the Ukraine and subsequent European Union (EU) and US sanctions against Russia, however, may alter Russian willingness to play the role of broker. Since oil and natural gas exports play significant role in the Russian economy, Russia might not be too enthusiastic to see the easing or the elimination of sanctions against Iran. Any lifting of sanctions would bring Iranian oil to the global market and might lead to further price reductions that would be detrimental to Russian interest. Russia is also actively seeking to increase its military arms exports (Rolander, 2014). The Iranians might prove to be a very willing customer for

Russian military equipment. Given these two facts, one wonders the extent to which the Russians would play a positive role in easing or eliminating sanctions.

The role of external political considerations needs to include China as well which is a significant trade partner of Iran. The EU has imposed its own sanctions against Iran, even though Germany is another major trading partner of Iran.

In 2014, the emergence of Islamic State of Iraq and Syria (ISIS) in Syria and Iraq produced a remarkable outcome. The old cliché “politics makes for strange bedfellows” became a reality when the United States became a *de facto* ally with Iran against the ISIS. Although both parties underplay or deny any implicit alliance against the ISIS, the reality exists that America and Iran wish to see a complete defeat and collapse of that organization. Adding to the confusion, the Shia–Sunni conflict is exacerbated by the fact that Iran is the *de facto* supporter of Shia interest in the Middle East while those who support Sunni interest are both American allies and antagonists.

The external political considerations, with respect to Iranian sanctions, are so convoluted and intertwined that it makes it difficult, if not impossible, to see a clear trajectory toward the solution of the sanctions situation.

### ***10.1.2. Economic Factors***

Obviously, the second factor influencing perceived national interests — economics — will play a significant role in the resolution of the Iranian sanctions problem. It is clear that the sanctions have had a profound effect on the Iranian economy far more so than the impact that sanctions have had on the American economy. We will discuss the ramifications of the sanctions on the Iranian economy later in this chapter. From a purely pragmatic standpoint, it would indicate that the Iranians should yield on their nuclear enrichment program and end any program, that might exist, for the development of nuclear weapons, but economics does not always trump all other considerations.

After the first Gulf War (1991), many military analysts argued that the key lesson to be learned from that war was that if you do not wish to be invaded by a coalition led by the United States there is only one alternative — have a nuclear weapon. The possession of a nuclear weapon may elevate the country that possesses one to a status of near invulnerability given the concept of deterrence. Nuclear powers have a great reluctance to ratcheting up conflicts among themselves. There is also the issue of elevating the status of the nation that has a nuclear capability. One must consider the perception of national pride. This brings us to a third factor that influences perceived national interest — culture.

Of the three factors, cultural issues might be the most difficult to consider when attempting to forecast the future state of American/Iranian relations. For nearly four decades, there's been very little in the way of direct cultural contacts between the United States and Iran. Each nation, to some extent, may be trapped in what has become a standardized cultural trap. Americans tend to see Iranians in the



context of the 1979 hostage incident. They also see the Iranian government as a consistent supporter of terrorists throughout the Middle East and the world. In a similar manner, Iranians have been fed a steady diet of seeing America as “the Great Satan.” Although many Americans and Iranians have a much more nuanced perception of the other, these relatively rigid cultural stereotypes can play an important role in dictating public opinion. In that light, it’s fairly remarkable that a significant majority of Americans support direct talks with Iran on the issue of nuclear program.

### ***10.1.3. Cultural Factors***

It is telling, however, that cultural norms can still play a powerful role in influencing perceptions. Some of these norms can only be considered to be quite ancient. Conflict between Persia/Iran and the West can be seen as dating back millennia. The Greek city states had several wars with the Persian Empire, culminating in Alexander the Great’s conquest of the Persian Empire. Centuries later the Roman Empire saw both the Parthian Empire and the Sassanid Empire (both essentially located in modern Iran) as major opponents. Such ancient conflicts may be unknown to most Americans, but for others they still possess their own reality. Iranian government officials and average Iranian citizens complained bitterly about the presentation of the Persian King Xerxes in the film “The 300” (Moaveni, 2007).

Considering that the film recounts the Spartan defense at the battle of Thermopylae over 2400 years ago, it would appear that the Iranians would agree with William Faulkner who said “The past is never dead. It’s not even past.” While some Iranian citizens may complain about the depiction of Persians in that film, many other Iranians look to the West and to the United States in particular for support to develop a true and open democracy in Iran. They wish to see Western “values” better incorporated into Iranian political and social life. Cultural values live and may have an impact on those involved in current negotiations.

## **10.2. Sanctions**

If we wish to understand the future of US/Iranian relations, we need to have a thorough understanding of the US, European’s, and the UN’s sanctions against Iran. In the case of the US sanctions, one should appreciate that there are two distinct types of sanctions — those created by Presidential Executive Order and those that have been passed as law by the US Congress. The understanding of the ramifications of these two types of sanctions with respect to future relations with Iran is critical. We will see that there have been a number of Executive Orders, more than two dozen, that have been issued across multiple administrations directed toward the sanctions

against Iran. These types of sanctions can be altered or reduced by a subsequent Executive Order. Essentially, Executive Orders are uniquely the prerogative of the President and Presidents have a wide latitude in issuing new Executive Orders. However, the US Congress has passed approximately nine acts related to sanctions against Iran. Eliminating these acts or even minor modifications to these acts requires the introduction of new legislation. As with any federal legislation, any new law related to Iranian sanctions would have to be introduced in Congress. Then passed on to appropriate committee, voted on, and passed through that committee and then it would have to be passed through both houses of Congress. One can easily appreciate how quickly changes to the sanctions against Iran can become part and parcel of the political conflicts and national aspirations of possible presidential candidates.

US sanctions leveled against Iran have had an evolutionary quality. [Clawson \(2015\)](#) has argued that there have been several rounds of US sanctions against Iran. The first set of sanctions began with the Iranians seizing the US embassy in Tehran. As a response, President Carter issued an Executive Order 12170 in November 1979. At the time it was not clear what the economic consequence and total value of freezing Iranian assets would represent. Initial estimates put them at \$8 billion, but subsequent analyses pegged the Iranian assets to be valued in excess of \$12 billion (Caswell, 1982).

When Saddam Hussein invaded Iran and precipitated the Iran–Iraq war, that action generated additional sanctions against Iran in 1984. To some extent this was precipitated by the perception that the Iranians were involved in the bombing of the Marine barracks in Lebanon. These sanctions focused on prohibiting any weapons sales to Iran. They also attempted to stop any and all international financial institutions from providing loans to Iran. Three years later President Reagan greatly extended these sanctions. His Executive Order 12613 attempted to prohibit the movement of all goods and services to and from Iran. Following the end of the Iran–Iraq war, trade between the United States and Iran began to rise slowly.

Years later, Executive Order 12959 was issued by the Clinton administration in March 1995. This was another round of ratcheting up of sanctions against the Iranians. It was directed toward ending any US involvement with Iran’s petroleum industry. Several months later, the Clinton administration followed this up with Executive Order 12959 which was designed to end all US trade with Iran. The American Congress also stepped in passing the Iran–Libya Sanctions Act (ILSA) in 1996. This was directed toward limiting foreign firm involvement with the Iranian petroleum industry. It outlined a number of penalties that could be leveled against firms that did business with Iran’s petroleum industry. Subsequently, the Iranians elected a new president (Khatami) who campaigned on a reformist agenda. This led to an easing of tensions between the United States and Iran. The Clinton administration relaxed some of the economic sanctions against Iran. Some of the eased restrictions involved increased access to medicine and selected consumer goods.

After the Iranians refused to comply with the International Atomic Energy Agency's examination of the Iranian nuclear program additional sanctions were put in place both by the United States and the UN. President George W. Bush issued an Executive Order that was particularly directed toward the Iranian nuclear program. President Obama has issued at least three Executive Orders designed to ratchet up sanctions on Iran. They have been directed against particular individuals, financial institutions, and the Iranian petrochemical industry.

In 2010, the US Congress passed the Comprehensive Iran Sanctions, Accountability and Investment Act (CISAIA). This significantly enhanced the sanctions on a broad number of Iranian goods and activities. It also eliminated the ability to import some Iranian consumer goods. The United States is not the sole source of sanctions against the Iranian government. The UN has provided a broad set of sanctions against Iran as has the EU and several other individual countries.

### ***10.2.1. UN Sanctions and Other Sanctions***

In addition to the United States, the UN has imposed sanctions against Iran. These were initiated with respect to Iran's suspected nuclear activities. In mid-2006, the United Nations Security Council (UNSC) passed Resolution 1696 threatening sanctions if Iran did not end its nuclear enrichment program. Less than six months later, in response to Iran's intransigence, the UN Resolution 1737 froze particular Iranian assets. In 2007, additional Iranian assets were frozen and the UN imposed an arms embargo on Iran. The following year, the UNSC extended the list of assets to be frozen and called for an examination of particular Iranian financial institutions. As a way of extending the arms embargo, in 2010, the UN passed Resolution 1929 which limited the operation of Iranian financial institutions in other countries. It also sought to limit the operations of the Iranian Merchant Marine. It was thought that such actions would restrict Iran's ability to acquire advanced military technology. These restrictions were extended for a limited time, in both 2011 and 2012.

The EU is relatively new to the notion of imposing sanctions on Iran in order to force compliance with respect to nuclear enrichment and the elimination of their nuclear weapons program. The EU sanctions were initially directed toward Iran's financial industry but were extended in 2012 to include an oil embargo on Iran.

Individual countries such as Japan, Canada, Australia, and even India and South Korea have initiated some forms of sanctions against Iran. Cumulatively, the impact of these sanctions has been devastating for the Iranian economy. Relaxation or the elimination of such sanctions would have a profound effect for the Iranian economic vitality. We will now examine how sanctions have impacted segments of the Iranian economy and how relaxation of such sanctions might impact the Iranian economy and particular sectors of the economy.

### **10.3. Overall Economy**

It needs to be pointed out that as extensive as US sanctions are against Iran, it does not mean that there is absolutely no trade between the two countries. Before the Iranian seizure of the US embassy, the United States was Iran's second largest trading partner. Much of the dollar value of that trade was associated with the Shah's buying binge of US military equipment. Trade between the United States and Iran can be quite volatile. In 2013, the dollar value of the trade between the two nations was nearly \$313 million. Yet, in 2014 that dollar value nearly dropped to half of the prior year's value. The majority of US exports are agricultural goods. It is important to know that with respect to balance of payments, the United States does extremely well against Iran. In 2013, more than 99% of the total value of the trade was US exports to Iran. Remarkably, that percentage was even higher in 2014. This imbalance can be explained by CISAIA which effectively eliminated any imports from Iran.

The Iranians have a mixed economy with some private enterprises, but many state-owned enterprises. Their economy is not considered as friendly to foreign investment. The Iranians make clear demands on the limitation of the operations of overseas investors.

The Iranians have devalued their currency with respect to the dollar on several occasions. Although such devaluations boost the Iranian competitiveness on the world scene with respect to some products, it is an additional burden on a nation that is seeking to import certain key goods such as food. The sanctions, particularly since the EU embargoed Iranian oil, have had a significant impact on the overall economy. The Iranians had been experiencing an inflation rate of approximately 40% immediately following the EU embargo (Berliner, 2013). The estimated annual inflation rate appears to have dropped in 2014 to approximately 15%. In the 2012/2013 period the Iranian economy contracted by nearly 6%. For the period 2013/2014 the economy still contracted but at a rate closer to 1.5% (Iran Overview, 2014). Unemployment is officially pegged at 10%, while most outside sources believe it to be much higher at perhaps 20%. Female and youth unemployment remains stubbornly high (Iran Overview, 2014). Although recent data indicates that there may be some positive outlook for the Iranian economy the overall set of numbers clearly indicate a nation in extreme difficulty.

#### ***10.3.1. Petrochemical Industry***

The petrochemical industry dominates the Iranian economy. Whatever impacts that industry ripples throughout the entire Iranian economy. The sanctions, particularly the EU sanctions and the Iran Refined Petroleum Sanctions act of 2009, brought significant contractions to Iran's oil exports. Some estimates indicated that immediately following the EU embargo, Iranian exports fell from over 2 million barrels per day to less than 900,000 barrels per day (*The Jerusalem Post*, 2012). The decline in

export of oil has eaten into Iranian reserves which has had profound consequences throughout the entire economy. It has also reduced the ability of the Iranians to reinvest in the petrochemical infrastructure. It's interesting to note that Iran has been forced to import some gasoline because of the decrepit state of their refining capacity.

When the EU imposed sanctions on importing Iranian oil, those same sanctions also prohibited European insurance firms from providing coverage for shipment of Iranian oil. The Europeans had supplied approximately 90% of such insurance. Although the Iranians have initiated a program of insuring their oil shipments, it has had an impact on the desirability of having Iran as a trading partner. Some people estimate that if sanctions were lifted, Iranian oil on a global market might produce as much as a 10% decline in the price of oil (DeRosa & Hufbauer, 2008).

### ***10.3.2. Banking and Finance***

As damaging as the sanctions have been on the Iranian petrochemical industry, sanctions that have been imposed on dealing with Iranian banks have had perhaps an even more profound negative effect on the overall Iranian economy. The United States has led the way in trying to isolate Iranian banks from the world's financial community. The largest Iranian banks are prohibited from having any financial interactions with US banks. That said, several Iranian banks have found ways to bypass these sanctions and be able to deal with US financial institutions indirectly. As late as 2013, the US government was adding more sanctions against Iran's financial community. In some cases, the US government argued that Iranian banks were passing money to Hezbollah and therefore to terrorist groups. Charges have been brought against individuals, companies, and banks for supporting Iran's ballistic missile and nuclear programs.

The EU has imposed its own set of sanctions against Iran. One of the most damaging was cutting off Iranian financial institutions from SWIFT, a program that allows for the financial transactions to occur among thousands of financial institutions across the world. Not having access to SWIFT means that the cost of financial transactions for Iranian banks is much higher than other banks or they are required to utilize cash or gold to pay for transactions. Some of the sanctions against particular Iranian banks have been overturned in a European Court.

### ***10.3.3. Science, Health, and Technology***

There has been a considerable concern on the part of US administrations and the US Congress to make sure that the Iranians did not have access to what is known as dual use technologies. Dual use technology refers to items that have explicit use in the commercial domain, but also may aid a country's military programs.

One of the results of current sanctions is that there has been a conscious attempt to isolate Iranian scientific community. More than 10 years ago, the US government made it a prosecutable offense for US citizens to collaborate with Iranian scientists. The same ruling also prohibited even the publication of scientific manuscripts from Iran. This has been contested by some American science associations. Relaxation or ending sanctions would enable Iranian scientists to rejoin the world community.

Relaxation or elimination of sanctions would have a significant impact on Iran's health industry. It has been estimated that American and EU sanctions reduced the importation of pharmaceuticals by 30% in 2012 (Namazi, 2013). Theoretically, based on humanitarian reasons, there are no substantive sanctions against the importation of pharmaceuticals; Iran, however, finds it difficult to import medicines because of constrictions placed on its financial institutions. Added to the problems associated with purchasing drugs through Iranian financial institutions, some drugs are restricted because they have been classified as "dual use" chemicals. Both factors have reduced the availability of some drugs important in fighting a wide variety of diseases. This aspect of the sanctions has been accused of causing many deaths (Borger & Dehghan, 2013). The Iranians have responded by importing drugs from both China and India. There has been concern about the quality of imports from both countries. Relaxing restrictions on Iranian financial institutions would be a major benefit to Iran's health care industry.

Perhaps one of the most significant impacts of a reduction in sanctions on technology would be in the area of civil aviation. US aerospace firms have been banned since 1979 from selling spare parts to either the Iranian military or the Iranian civil aviation industry.

In late 2014, Boeing was allowed to sell to Iran some aviation-related items. None of these were spare parts. They involved the sale of manuals and during this period the sale was relatively minor. Earlier in the same year the US government gave permission, through export licenses to both Boeing and General Electric to sell the Iranians spare parts. This follows a Bush administration granting of license to Boeing for the sales to Iran. Neither Boeing nor General Electric has made any statement about whether they would make an offer to Iran Air. Again, the hesitation may be predicated upon working through Iranian banks and finding that there would be additional restrictions.

The Iranian civil aviation industry has one of the most ageing air fleets in the world. This has produced numerous problems including many major air crashes. It has been reported that during the "last 25 years there have been more than 200 accidents involving Iranian planes, resulting in 2000 deaths" (Handjani, 2014). If Boeing and other American aerospace firms had more financial options for dealing with Iran Air, one could easily envision some significant sales of aircraft parts and new aircrafts. This would benefit the most export-driven industry in the United States — aerospace, and benefit Iranian civil air transport by improving its safety.

## 10.4. Conclusion

The current negotiations with Iran offer the world a unique win–win proposition. If Iran promises to curtail its nuclear enrichment program and makes its nuclear facilities open to international nuclear agency inspections and thus proving they do not have an active nuclear weapons program, the world would have taken a huge step forward in limiting nuclear proliferation. Confirmation that there is no Iranian nuclear weapons program would reduce Israel anxieties about an existential threat to their existence. This would eliminate the possibility of an Israeli military strike against Iranian nuclear facilities. Iran would probably retaliate in attacking Israel through its surrogates Hezbollah. The United States (and possibly some allies) would not have to take military action to prevent Iran from acquiring a nuclear weapon as several administrations have promised. Most likely Iranian response to US air assaults on their nuclear facilities would be to attempt to close the Strait of Hormuz. Although the Iranian government has denied any intention to close the Strait, one merely has to examine Iran's acquisition of conventional weapons to see that they definitely have the capability to carry out such an action. Closing the Strait of Hormuz would effectively stop the flow of oil from the Middle East throughout most of the world. The consequences of such an action boggle the imagination. The global economic consequences would be horrific.

Any US military strikes against Iran would guarantee that they would no longer cooperate, behind-the-scenes, in dealing with the ISIS threat. A nuclear armed Iran might provoke sufficient anxiety in some Sunni majority countries in the Middle East, such as Saudi Arabia and Egypt, to have them initiate their own nuclear weapons program. Clearly, it is in America's national interest to hope that these negotiations are successfully concluded and that they are concluded rapidly. Yet many politicians and US citizens view the continued negotiations as an Iranian ploy — a way for the Iranians to continue their nuclear weapons program while easing the penalty of sanctions. Easing sanctions as part of the negotiation process is viewed by them as appeasement. They believe that the only way to force Iran to yield is to increase the severity of the sanctions. They view that approach is the best way of serving long-term American interests.

From a pure economic standpoint, it is in Iran's best interest to also hope for a successful conclusion to these negotiations. The upside of having the United States, the EU, the UN, and other nations sanctions eased or removed is blatantly obvious. However, we have pointed out that the determination of national interest is not always predicated, singularly, upon economics alone. As with any other nation, internal Iranian political struggles can tip the decision one way or the other. Military considerations can make a country view nuclear weapons as the ultimate trump card. It provides a degree of immunity from foreign invasion or attack and may be worth any cost. National pride and public opinion can influence the decision. The notion that external forces — the United States, the EU, or the

UN — can dictate national policy would rankle the citizens of most countries. Like the United States, Iran possesses a series of conflicting forces that either favored continued negotiations or reject them.

At this point, it may seem strange to evoke the name Niccolo Machiavelli. His political tracts have led to an eponymous epithet — Machiavellianism. One can argue whether such a negative reputation is truly deserved, but there are two concepts that Machiavelli refers to in “The Prince” that may have some meaning in the current situation. He emphasizes two important factors in politics “*Virtu*” and “*Fortuna*” which correspond to “Virtue” and “Fortune.” Machiavelli’s take on both terms is somewhat different than contemporary interpretations. Virtue (*Virtu*) represents the characteristics of a leader who is willing to take decisive actions to achieve the ends that he/she desires. Fortune (*fortuna*) is not, to Machiavelli, identical with fate. It represents the vicissitudes that all individuals are confronted with in life. To Machiavelli, the sign of a leader is the individual who sees opportunity in the future and applies his/her virtue to achieve the ends that they want. In that sense, the current round of negotiations constitutes a superlative opportunity for both parties to make decisions in their own best national interest. To achieve that successful outcome both nations need leaders who possess “virtue” and that they are willing to take the steps to accomplish the outcomes that they desire. It remains to be seen if that is the case, but we can only hope that it is.

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## Chapter 11

# Concluding Thoughts from the Editors

Mohammad Elahee, Farid Sadrieh and Mike Wilman

It is striking how often Iran has been conspicuous by its absence in global economic, diplomatic, political, and strategic gatherings. Often this absence has been because the participants wished it away, despite being aware of its influence and importance. Iran has long been the proverbial “elephant in the room,” of critical relevance, but studiously ignored by all. For over 36 years, it has been treated and more often than not, behaved, as a major threat to global peace, stability, and prosperity. That is beginning to change, despite fierce resistance from those interests vested in the status quo. The status quo is changing, for the better or for the worst. New threats are emerging, like the violent spread of Sunni extremism across the Middle East and new hopes are taking shape, like the coming of age of a new generation of Iranians yearning for change. Suddenly, a tantalizing question no longer seems farfetched: can Iran be part of the solution rather than part of the problem?

It is too early to answer this question, but thanks to the US-Iranian rapprochement over the last few years, something that itself was unimaginable not that long ago, it has been at least acknowledged that the question is worth investigating. The catalyst for that exploration has been the commitment of both sides to earnestly seek, through negotiations, a mutually acceptable solution to the nuclear dispute. Success is by no means assured and at the time that these lines are being written the outcome is still very much uncertain. Nevertheless, it seems certain that something has already changed, walls of mistrust have cracked, even though they are far from having crumbled, and there is no going back. The word “historic” has been

overused and misused, but there is no other way to describe an agreement, should it come to pass.

It is in recognition of all of the above that the editors set out to bring to print the book that you have in your hands. The awareness that we were standing at a threshold, at the beginning of a new relationship with Iran, with its unpredictable twists and turns full of perils but also rich with promise, made it imperative to help an international audience rediscover this fascinating country. Our focus has been the economic aspects of Iran's global reintegration, others will doubtlessly address the many other facets of the country's return in the concert of nations. However, even within the limits that we have traced, this book is far from capturing all the complexities of Iran's economy. Much remains to be said. For example, a number of other sectors of the economy, from healthcare to banking to information technology merit to be investigated in their own right. The economic relations of Iran with Turkey, the Persian Gulf states, and other trading partners need to be addressed separately. The issues of governance and the need for privatization offer yet other avenues for exploration. We readily acknowledge these shortcomings and are confident that others will fill the gaps. We would also have liked to include contributions from scholars living and working in Iran, but the economic sanctions in place prohibit and preclude any such collaboration. The irony of this situation is not lost on the editors who hope that soon, researchers would no longer face such restrictions.

In sum, our ambition was to bring a much needed and much delayed focus on Iran and its future role in the world economy, calling on scholars with a wide variety of expertise to share their knowledge and contribute their original views. We are indebted and grateful to them for having risen to the task and met the challenge, often under strict time constraints. We hope that you, the reader, have found their perspectives as insightful and enlightening as we did.